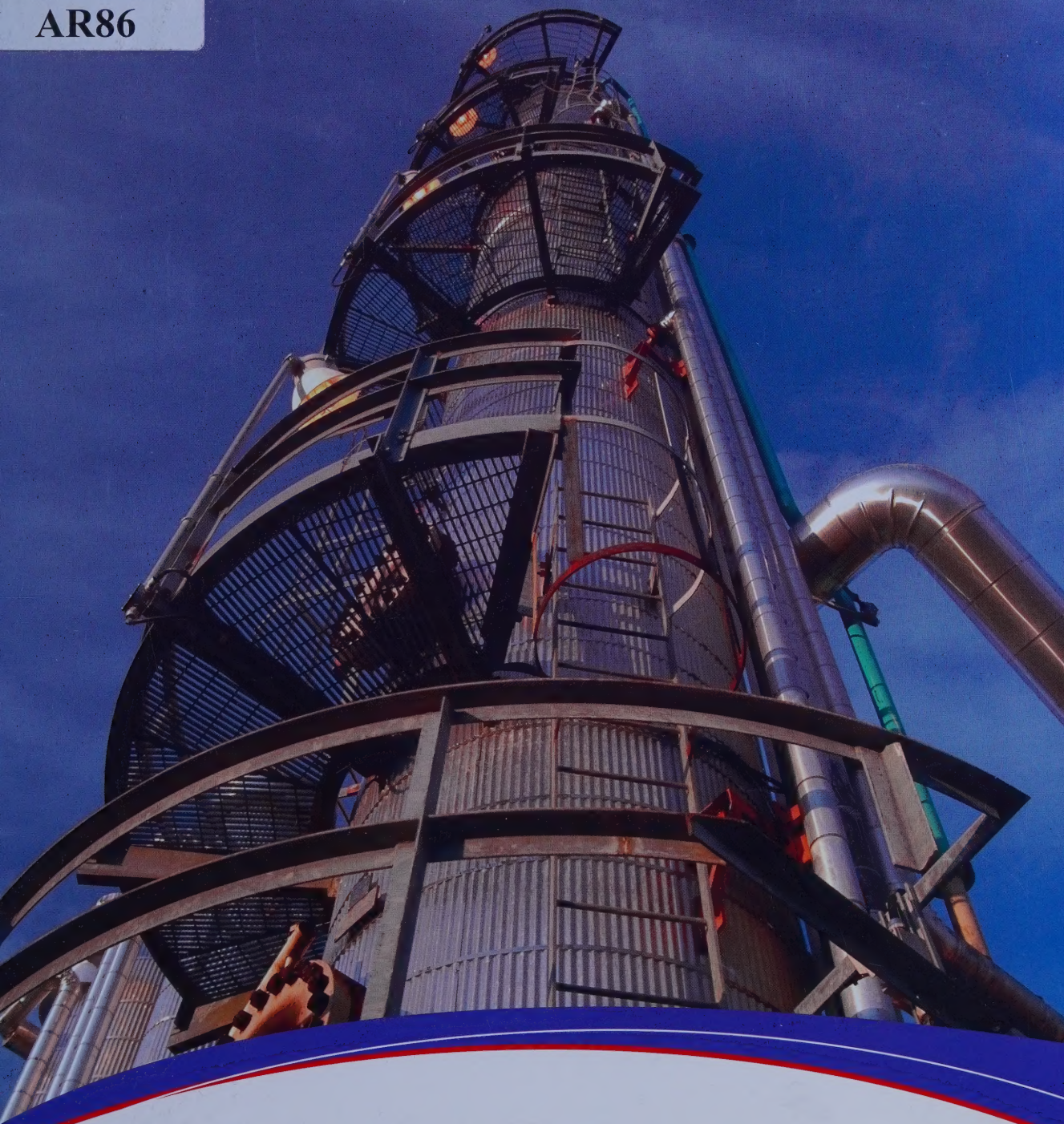


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**ENERCHEM**  
INTERNATIONAL INC.

2006 ANNUAL REPORT



**Enerchem International Inc.** is a manufacturer and distributor of hydrocarbon drilling and fracturing fluids designed to provide cost effective solutions to the upstream oil and gas industry and specialty solvents to help resolve production and processing problems to the downstream producers. The Company also provides energy marketing services and, through its wholly-owned subsidiary company, Millard Trucking Ltd., provides fluid transportation and other related oilfield services. The Company's common shares trade on the Toronto Stock Exchange under the symbol "ECH".

## **Our Mission Statement**

Enerchem manufactures and markets quality hydrocarbon solvents, drilling and fracturing fluids to the oil and gas industry, through its state of the art trucking fleet in a safe and environmentally conscientious manner. We are committed to a culture that is based on sound business ethics, focused on enhancing shareholder value.

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## **Annual General Meeting**

The Annual General Meeting of the Shareholders will be held on:  
Wednesday May 16, 2007 at 2:00 pm  
At "The Palace" Holiday Inn - Versailles Room  
4235 Gateway Boulevard  
Edmonton, Alberta



## Financial Highlights

### Results of Operations

For the year ended December 31	2006	2005
	\$	\$
Revenues	107,746,214	109,132,279
Net earnings		
Continuing operations	5,930,576	3,884,508
Discontinued operations	-	4,290,230
Net earnings for the year	5,930,576	8,174,738
Basic earnings per share		
Continuing operations	0.39	0.26
Discontinued operations	-	0.29
Net earnings per share basic	0.39	0.55
Diluted earnings per share		
Continuing operations	0.39	0.26
Discontinued operations	-	0.29
Net earnings per share diluted	0.39	0.55
EBITDA (1)	10,355,875	6,974,289
EBITDA per share (2)	0.68	0.47

### Financial Position

Total assets	68,554,555	73,921,005
Working capital (3)	20,650,126	23,553,974
Total long-term debt (4)	171,477	1,832,276
Shareholders' equity	56,053,597	48,224,692
Number of shares		
Outstanding, end of year	15,295,307	14,820,807
Average, during the year (5)	15,171,836	14,793,712

(1) represents earnings before interest, taxes, depreciation, amortization, accretion expense and write-downs.


(2) calculated as EBITDA divided by the basic weighted average number of shares outstanding during the year.

(3) calculated as current assets less current liabilities

(4) excludes current portion of long-term debt

(5) represents the weighted basic average number of shares outstanding during the year





## President's Message

### Our Vision

"Enerchem manufactures and markets quality hydrocarbon solvents, drilling and fracturing fluids to the oil and gas industry, through its state of the art trucking fleet in a safe and environmentally conscientious manner. We are committed to a culture that is based on sound business ethics, focused on enhancing shareholder value."

### To Our Shareholders,

On behalf of the employees and the Board of Directors of Enerchem International Inc., I am pleased to report the operational and financial results of the Company for the fourth quarter and year ended December 31, 2006.

2006 proved to be a very interesting year from an operational perspective. During the first half of the year we experienced high levels of demand for our products as we benefited from record oilfield activity in most areas of the Western Canadian Sedimentary Basin ("WCSB"). However during the second half of 2006, the lingering effects of warmer winter conditions over recent years combined with the build-up of higher than normal gas inventory levels contributed to weaken near-term natural gas prices and precipitate a slow-down in oilfield activity. While the shallow gas areas of the WCSB saw reduced activity levels throughout the second half of 2006, the deeper more technical areas serviced by the Company experienced a more gradual slowdown which started part way through the fourth quarter of 2006. During this slowdown period, many of the oil and gas producers reduced their capital expenditure budgets and announced their reluctance to start any new projects until they had a better idea on the direction of oil and gas prices.

However, despite these changes in activity levels, we were able to establish a number of new financial and operational records. First and foremost, we completed another year of operating our plants lost time incident free. This culminates to our plants operating lost time incident free from the start of their respective operations under the Company. We achieved record earnings from continuing operations of almost \$6.0 million, EBITDA, which represents our earnings before interest, taxes, depreciation, amortization, accretion expense and write-downs, improved to over \$10.0 million, return on capital employed of almost 15% and we exited the year with essentially no debt and working capital of \$20.7 million. The acquisition of Millard Trucking during the second quarter provided new sources of third party revenue and also helped our own internal trucking requirements.

### Continued Improvement

Over the past year we implemented several significant strategic initiatives focused on increasing plant efficiencies and improving overall operational performance.

In Sundre, we completed the automation of fractionation towers two and three which provided a 14% increase in our finished product output. The plants blend facility was completed during the second quarter of 2006 and has improved the return on our by-products that are sold through the energy marketing group. During the third quarter of 2006, we commenced with the construction of our flowback cleaning facility which will be operational late in the 1st quarter 2007. We anticipate that this facility will contribute to reducing our overall feedstock costs and provide competitive advantages. In 2007, we will be replacing the older style salt bath heaters used by the Sundre plant with a new higher temperature rated heating system that will reduce the plants energy consumption and increase its production throughput.

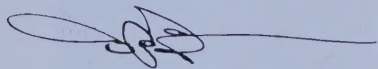
In Slave Lake, we completed the refrigeration plant and storage bullet which provided an incremental revenue stream from the sale of liquid petroleum gas and reduced plant emissions. In 2007, our capital program for the Slave Lake plant will be focused on the construction of a blending facility, that we anticipate will be pipeline connected, to complement our energy marketing activities and the construction of a crude oil water-wash process that we expect will reduce our maintenance costs between turnarounds.

### **Cautiously Optimistic**

The current forecast for drilling activity in 2007 ranges from 19,000 to 21,000 wells to be drilled in the WCSB. Notwithstanding the forecasted drop in wells drilled when compared to 2006, the Petroleum Services Association of Canada (PSAC) predicts that operating days will go from approximately 175,000 to 159,000, which indicates a greater focus by the oil and gas producers on deep well drilling activities. As a result, this should provide normal anticipated opportunities for our products and services in 2007.

### **Acknowledgements**

I would like to sincerely thank our Board of Directors for their guidance throughout the year, our shareholders for their continued support and finally, I would like to extend my personal gratitude to our employees. I'm truly grateful for their commitment, innovation and dedication to the success of Enerchem.



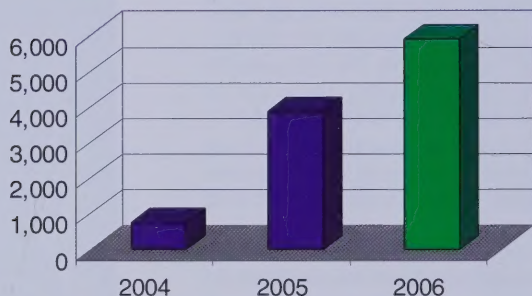
Douglas F. Robinson  
President and Chief Executive Officer



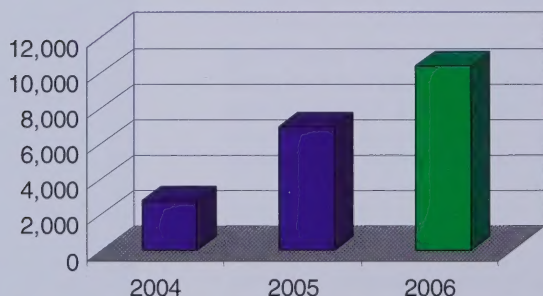


## 2006 Year in Review

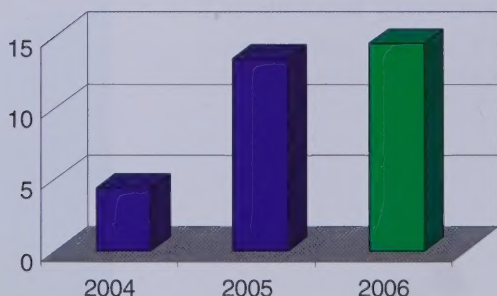
**Net earnings from continuing operations**  
(\$ thousands)



**EBITDA from continuing operations**  
(\$ thousands)



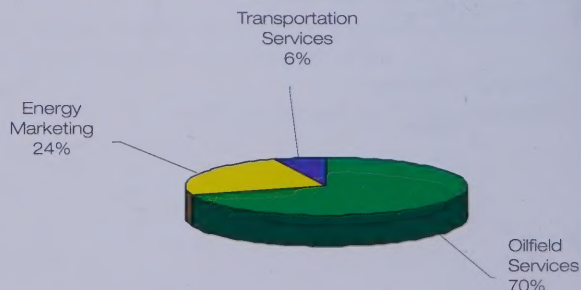
**Return on average capital employed (ROACE)**  
(percent)



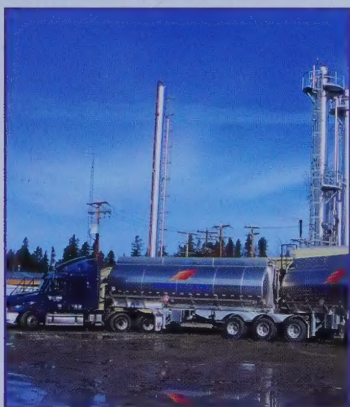
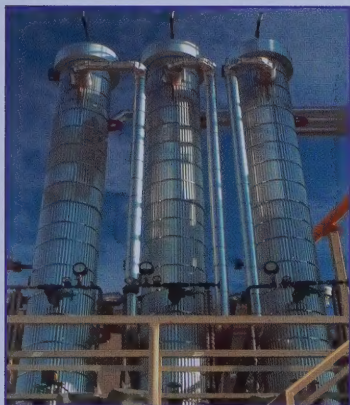
## Financial Highlights

- Achieved record earnings from continuing operations of \$5.9 million, or \$0.39 per common share, representing a 53% increase from last year's record year.
- EBITDA improved by 48% to \$10.4 million in 2006 from \$7.0 million in 2005.
- Acquisition of Millard Trucking Ltd., effective May 1, 2006, provided new revenue opportunities of \$6.7 million.
- Enerchem maintained a strong balance sheet with improved cash flow from operations and during 2006 repaid bank indebtedness and long-term debt obligations totaling \$7.8 million.
- Return on shareholders equity improved to 11.4% in 2006 from 8.9% in 2005.
- Return on average capital employed improved to 14.5% in 2006 from 13.5% in 2005.

**2006 Consolidated revenues - by business segment**  
(percent of consolidated revenues)



## 2006 Year in Review



### Operating Highlights

- During the first quarter of 2006, completed construction of the refrigeration plant and bullet at the Slave Lake fractionation plant which provided an incremental revenue stream from the sale of liquid petroleum gas and improved plant emissions control.
- Continued year-over-year growth in the volume of manufactured products sold by the Company.
- Maintained strong safety performance record, with all facilities operating lost-time incident free throughout the year.
- The acquisition of Millard has added substantial transportation infrastructure to facilitate the Company's fluid hauling requirements at reduced costs.
- Automation of the Sundre fractionation plant which improved its production yield by 14%.
- Feedstock storage capacity at the Slave Lake plant increased to 8,300 m<sup>3</sup> from 4,800 m<sup>3</sup> with the expansion of its tank farm.
- During September 2006, commenced with the construction of the Company's flowback facility in Sundre, Alberta which is scheduled for completion during the first quarter of 2007.

**Top** - Slave Lake plant side-strippers used to remove impurities from our finished products.

**Middle** - Flowback facility under construction in Sundre, Alberta.

**Bottom** - State-of-the-art transportation fleet.





## Health, Safety and Environmental

Enerchem places the importance of safety above all other aspects of the Company's business. Enerchem recognizes that its employees represent its most valuable asset and must be provided with the tools and systems necessary to carry out their work in a safe environment.

We have initiated comprehensive policies and procedures to ensure the health and safety of all our employees, contractors, sub-contractors and visitors.

Enerchem holds a Certificate of Recognition ("COR") for all of its business operations. The COR recognizes that our health and safety management systems meet the Standards of Partnerships developed by Alberta Human Resources and Employment. We are proud that our employees have maintained an excellent safety performance record and that all facilities have operated lost-time incident free throughout the year.

We also have implemented programs and guidelines to eliminate our environmental exposures. All environmental laws and regulations are adhered to, including Alberta's Environmental Protection and Enhancement Act, the Canadian Environmental Protection Act, the Transportation of Dangerous Goods Regulations and the Environmental Operating Guidelines for the Alberta Petroleum Industry.

## Corporate Governance

Full disclosure with respect to the Toronto Stock Exchange Corporate Committee requirements is contained in the Information Circular of Enerchem International Inc., prepared for the Annual General meeting to be held on May 16, 2007.

The main corporate governance practices followed by Enerchem involve the assumption by the directors of responsibility for stewardship of the Company. Enerchem's Board of Directors comprises seven members, five of whom qualify as unrelated directors by virtue of their independence from management or any interest, business or other relationship that could materially interfere with the directors' ability to act in the best interests of the Company. The Board of Directors has four committees being: the Audit Committee, the Compensation Committee, the Environmental Committee and the Strategic Planning and Priorities Committee.

Enerchem is committed to the objectives of the corporate governance policy established by the Toronto Stock Exchange and will continue to work toward complying with the objectives set forth therein.



## Directory

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### Corporate Office

Enerchem International Inc.  
1950, 777 - 8 Avenue S.W.  
Calgary, Alberta  
CANADA T2P 3R5  
T: 403.269.1500  
F: 403.269.1559  
website: [www.enerchem.com](http://www.enerchem.com)

### Board of Directors

Larry B. Phillips  
Chairman of the Board  
Director (2), (4)

Douglas F. Robinson  
President and Chief Executive Officer  
Director (3), (4)

Kenneth A. Klein, B. Comm.  
Director (1), (2)

William D. Burch, FCA  
Director (1)

Hugh L. Planche, B. Comm.  
Director (2)

David F. Potter  
Director (1), (2), (4)

Kevin M. Maguire, P.Eng., MBA  
Director (1), (4)

### Officers

Douglas F. Robinson  
President and Chief Executive Officer (3), (4)

Brian M. Zubach, B. Admin., CMA  
Chief Financial Officer

J. Barrie Brookman  
Vice President, Corporate Development (3)

Member of:

- (1) Audit Committee
- (2) Compensation Committee
- (3) Environmental Committee
- (4) Strategic Planning and Priorities Committee

## Directory

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### Registrar and Transfer Agent

CIBC Mellon Trust Company  
320 Bay Street  
Toronto, Ontario CANADA M5H 4A6  
T: 800.387.0825  
[www.cibcmellon.com](http://www.cibcmellon.com)

### Principal Bank

HSBC Bank Canada  
Edmonton, Alberta

### Auditors

PricewaterhouseCoopers LLP  
Edmonton, Alberta

### Legal Counsel

Chamberlain Hutchison  
Edmonton, Alberta

### Stock Exchange Listing

Toronto Stock Exchange: trading symbol "ECH"  
United States - Over the Counter 12g-3-2(b)



## Management's Discussion and Analysis ("MD&A")

This MD&A focuses on key statistics from the financial statements of Enerchem International Inc. ("Enerchem" or the "Company") and pertains to known risks and uncertainties relating to the oilfield services industry in Western Canada where the Company operates. This discussion should not be considered all inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. This discussion and analysis of the Company's financial condition and results of operations for the year ended December 31, 2006 should be read in conjunction with the audited annual consolidated financial statements and related notes and material contained in other parts of this Annual Report and the Company's Annual Information Form. Additional information relating to the Company is available on the System for Electronic Document Analysis and Retrieval ("SEDAR") at [www.sedar.com](http://www.sedar.com). This MD&A was prepared effective March 19, 2007.

*Certain statements contained in this Annual Report, including statements contained in this MD&A, that are not historical facts may be considered "forward looking statements." Forward looking statements are often identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "project", "potential", "targeting", "intend", "could", "might", "should", "believe", and similar expressions. Such statements are based on current expectations that involve risks and uncertainties which could cause actual results to differ from those anticipated. Important factors that can cause anticipated outcomes to differ materially from actual outcomes include the impact of general economic conditions, industry conditions, competition from other industry participants, volatility of petroleum prices, the ability to attract and retain qualified personnel, changes in laws or regulations, currency fluctuations, continued ability to access capital from available facilities and environmental risks. The Company believes that the expectations reflected in those forward looking statements are reasonable but no assurances can be given that these expectations will prove to be correct and such forward looking statements included in this Annual Report should not be unduly relied upon. These forward looking statements are made as of the date hereof and the Company assumes no obligation to update or revise them to reflect new events or circumstances. References in this MD&A to "Enerchem", "Company", "us", "we", and "our" mean Enerchem International Inc.*

## Vision, Core Businesses and Strategy

Enerchem manufactures and markets quality hydrocarbon solvents, drilling and fracturing fluids to the oil and gas industry, through its state of the art trucking fleet in a safe and environmentally conscientious manner. We are committed to a culture that is based on sound business ethics focused on enhancing shareholder value.

## Business of the Company

Enerchem International Inc. is a provider of hydrocarbon fluid solutions designed to resolve oilfield processing and production problems. The Company's hydrocarbon fluids provide measurable productivity increases, operating and maintenance cost reductions and solutions to environmental problems. The Company's proprietary hydrocarbon products are manufactured through its facilities located in Sundre and Slave Lake, Alberta. The Company's fracturing and drilling fluids and solvent products ("Specialty Fluids") are manufactured from these locations. Enerchem's products are marketed and distributed through its network of sales and service representatives. During the third quarter of 2004, the Company diversified its operations with the establishment of its Energy Marketing group. This diversification was precipitated to maximize value received by the Company for its hydrocarbon by-products, provide energy marketing management and expertise and, to mitigate in part, the Company's exposure to the seasonality of its operations. During the second quarter of 2006, the Company acquired all of the outstanding common shares of Millard Trucking Ltd. ("Millard"), a privately owned company based in Sundre, Alberta, that provides transportation services and other oilfield services to the oil and gas industry. As a result, the Company's activities are divided into three distinct business segments: Oilfield Services which represents the manufacture and sale of hydrocarbon products; Energy Marketing which represents the purchasing, gathering and marketing of petroleum for resale to refiners and other customers; and Transportation Services which represents the operations of Millard. The operations of the Company are conducted entirely within the Western Canadian Sedimentary Basin ("WCSB").

The Company's international operations presently represent a 25% investment in an Egyptian company, Egyptian Canadian Company for Chemicals Industries – F.Z. ("ECC"), which operates a blend plant in the free zone area of Alexandria, Egypt. Enerchem has invested \$750,000 U.S. in this Egyptian company and accounts for its investment on the cost basis as the Company does not exercise significant influence. As a result, earnings from the Company's Egyptian investment are recognized only to the extent received or receivable. Subsequent to December 31, 2006, the Company made arrangements with a privately held Egyptian company based in Cairo, Egypt for the sale of its 25% interest in ECC for total proceeds of \$750,000 U.S. Further details of this divestiture are provided in the notes to the Company's financial statements under note 7 (a), Other assets: Investments – foreign operations.

On December 31, 2005, the Company sold its specialty chemical operations which included inventories and property, plant and equipment for \$13,244,000. The net gain on the sale of the specialty chemical operations amounted to \$3,747,000 after income taxes of \$1,484,000. Details of this divestiture are provided in the notes to the Company's financial statements under note 5, "Discontinued operations". The comparative figures for the year ended December 31, 2005 have been restated for discontinued operations.

## Business Strategy

Enerchem's distinct business advantage is that its facilities, situated in Western Canada, are dedicated to providing a diversified range of proprietary hydrocarbon fluids that achieve consistency in product quality to meet oil and gas processing and production requirements common to the WCSB. The Company wants to capitalize on its position and to provide above average returns on investment to its shareholders. To accomplish this, the Company's business strategy is focused on:

- Becoming a low cost producer of quality Specialty Fluids that provide the best customer value;
- Establishing a more consistent revenue base facilitating stable earnings during seasonal slowdowns in oilfield activity; and
- Optimizing its infrastructure and facilities capabilities to capture identified market opportunities and that provide competitive advantages.

A substantial component of the Company's future organic growth and profitability is incumbent on its continued ability to successfully market and maximize value received for its Specialty Fluids and by-products. This success hinges on the Company's ability to secure sufficient quantities of crude oil ("feedstock") for its production requirements to meet customer demand, cost effective transportation structures and its ability to reflect the underlying value of the Company's products to the retail markets. To accomplish this, the Company's business strategy is focused on:

- Securing favourable long-term feedstock arrangements providing opportunity to maximize the Company's production capabilities;
- Optimizing the capabilities of its manufacturing processes and internal know-how;
- Optimizing its fluid transportation arrangements and infrastructure;
- Optimizing its business opportunities and operating synergies available through its energy marketing capabilities.

## Key Performance Drivers

Enerchem believes the following key performance drivers are critical to the success of the business:

- Hydrocarbon prices, which influence the capital expenditure programs and resulting oilfield activity levels of exploration and development companies in the WCSB;
- Weather, which affects the Company's ability to operate in key locations of the WCSB;
- Access to, and retention of, qualified personnel;
- Access to hydrocarbon feedstocks compatible with the Company's plant processing and product quality requirements;
- Expectations of its customers regarding oil and gas exploration and development prospects in the WCSB;
- A continued ability to offer competitive product pricing; and
- Continued access to terminalling facilities required by the Energy Marketing segment to accommodate the delivery of its by-products and the purchasing, gathering and marketing of petroleum for resale to refiners and other resellers.

There are several key performance measures the Company uses to monitor and assess its performance relative to the key performance drivers, the implementation of its strategy, and the achievement of its goals and vision.



Some of the Company's key financial performance indicators and results against those indicators for its continuing operations are set out below:

Key financial performance indicators - continuing operations

At December 31	2006	2005
Total revenue growth	(1)%	72%
Revenue growth – Oilfield Services segment	5%	48%
Total gross profit percentage	19%	15%
Gross profit percentage – Oilfield Services segment	19%	17%
Net earnings as a percentage of revenues	5.5%	3.6%
Basic net earnings per common share	\$ 0.39	\$ 0.26
Return on average capital employed (ROACE)	14.5%	13.5%

Return on average capital employed is a non-GAAP measure which the Company has defined as the ratio of earnings before income taxes and interest on debt to average capital assets.

In addition, the Company has key operating performance indicators that include but are not limited to: market share, product profitability, product quality and assurance, plant productivity, productivity improvements and waste reduction and operating and administrative cost management.

## Capability to Deliver Results

### Non-Capital Resources

People are the most critical non-capital resource required in order for the Company to achieve its goals set out in its strategic plan. A formal human resource plan has been implemented in order to ensure the Company focuses on improving and maintaining its employee morale. The Company is continually evaluating its human resource levels to determine if levels are adequate and adequately trained to meet its business requirements. The Company believes that it presently has sufficient human resources to successfully operate its business and to execute its strategic plan.

### Capital Resources

The Company has the necessary working capital to meet its current obligations and commitments. The Company maintains a fleet of leased field service vehicles and leased premises which represent its off-balance sheet financing arrangements. During 2006, the Company used cash flows from its operating activities to fund its capital projects in Sundre and Slave Lake, Alberta. In order to finance future capital expenditure obligations and future growth, Enerchem anticipates financing its activities through a combination of available cash and cash equivalents, cash flow from operations and, when necessary, utilizing its existing credit facilities. Due to the long term nature of its assets and its historical cost of capital, the Company believes that it must provide an annual return of 10% to 15% on average capital employed over the life of its asset base in order to be financially accretive for shareholders and to minimize Enerchem's cost of capital.

### Systems and Processes

The Company's operational systems and processes are continuously reviewed by management. During 2006, the Company continued to assess and, where appropriate, modify its compensation system to ensure market competitiveness and to align its human resources to the attainment of the Company's strategic objectives. The Company also continues to evaluate and implement methods and infrastructure to facilitate increased productivity of its fractionation plants in Slave Lake and Sundre and continues to evaluate processes that will contribute to reduce overall feedstock costs. The foregoing systems and process modifications will align the Company to execute its strategic plan.

## Seasonality of Operations

Weather conditions can affect the sale of the Company's products and services. The ability to move heavy equipment in the Canadian oil and natural gas fields is dependent on weather conditions. As a result, spring months in Western Canada and the duration of this "spring break-up" has a direct impact on the Company's activity levels. In addition, exploration and production in many of the northern regions of the WCSB are accessible only in winter months when the ground is frozen hard enough to support the weight of heavy equipment. The timing of freeze-up and spring break-up affects the ability to move equipment in and out of these areas. As a result, late March through May is traditionally the Company's slowest period.

## Trends and Outlook

During the fourth quarter of 2006, the Company's operations were affected by the continued weakness in natural gas prices and the decline in crude oil prices which resulted in producer budget cutbacks and a slowdown in oilfield activity levels. While we are still early into the first quarter of 2007, industry activity levels continue to be below 2006 levels. While oil prices have moderately rebounded from levels experienced during the fourth quarter of 2006, natural gas prices have continued to show near-term weakness. As a result, general industry uncertainty relative to 2007 oilfield activity continues to prevail. We continue to be cautiously optimistic that industry drilling activity for 2007 will range from approximately 19,000 to over 21,000 wells drilled and that the regions serviced by the Company in the WCSB will provide normal anticipated demand for our products and services for 2007.

## Selected Annual Information

Selected annual financial information derived from the audited financial statements for the three most recently completed financial years is set forth below and is prepared in accordance with generally accepted accounting principles in Canada:

For the years ended December 31	2006	2005	2004(1)
	\$	\$	\$
Revenues	107,746,214	109,132,279	63,619,257
Net earnings from continuing operations	5,930,576	3,884,508	759,654
Net earnings per share from continuing operations			
Basic	0.39	0.26	0.05
Diluted	0.39	0.26	0.05
Net earnings from continuing operations	5,930,576	3,884,508	759,654
Net earnings from discontinued operations	-	4,290,230	1,201,046
Net earnings for the year	5,930,576	8,174,738	1,960,700
Net earnings per share			
Basic	0.39	0.55	0.14
Diluted	0.39	0.55	0.13
Total assets	68,554,555	73,921,005	61,653,226
Total long-term financial liabilities	171,477	1,832,276	3,042,634

(1) Restated to reflect the sale of the Company's specialty chemical operations.

Total revenues from continuing operations in 2006 decreased by 1% when compared to 2005 and were 72% greater than revenues achieved in 2004. The decrease in 2006 revenues when compared to 2005 resulted from the decline in the Company's Energy Marketing activities. During the second quarter of 2005, the third party facility used by the Energy Marketing segment in executing its activities was affected by a change of ownership, which limited the operational flexibility previously available to this business segment. As a result, Energy Marketing revenues in 2006 declined to \$25,423,000, or by 31%, when compared to 2005 revenues of \$37,060,000. Oilfield Services revenues increased by 5% to \$75,668,000 in 2006 when compared to 2005 revenues of \$72,072,000 and by 55% when compared to 2004 revenues of \$48,667,000. The increase in Oilfield Services revenues in 2006 when compared to 2005 and 2004 can be attributed to: the year-over-year increase in oilfield activity levels and corresponding increase in the volume of products sold by the Company; and product price increases in step with the underlying increase in feedstock costs. The acquisition of Millard, effective May 1, 2006 added revenues of \$6,655,000, excluding inter-segment revenues of \$3,390,000. On December 31, 2005, the Company sold its specialty chemical operations which included the inventories and property, plant and equipment associated with these operations. The net gain on the sale of the discontinued operations amounted to \$3,747,000 after income taxes of \$1,484,000. Revenues from its discontinued operations were excluded from total revenues in the amount of \$15,789,000 for 2005 and \$17,213,000 for 2004.



The improvement in net earnings from continuing operations for fiscal 2006 when compared to the years 2005 and 2004 primarily reflects the year-over-year growth in the volume of the Company's manufactured products sold which was largely influenced by: the effects of the year-over-year increase in activity levels in the WCSB; continued improvements in the manufacturing capabilities of the Company's fractionation plants; retail product price initiatives that were largely in step with the underlying increase in feedstock costs; improved pricing arrangements for its by-products; the effects of reductions in the general tax rates to be phased in over the next five years; and the benefits attributable to the Millard acquisition.

As at December 31, 2006, the Company experienced a 7% decline in total assets when compared to the year ended December 31, 2005. This decline in the Company's total assets on a comparative period basis largely reflects the decline in trade accounts receivable outstanding due to the decrease in oilfield activity levels during the fourth quarter of 2006 caused by the decline in oil prices and continued weakness in natural gas prices. The drop off in oilfield activity during the fourth quarter of 2006 precipitated a 17% decline in the volume of product sold by the Company when compared to the same period in the previous year with the largest decline in product volumes affecting the Company's drilling fluids. During the fourth quarter of 2006 drilling rig utilization rates in the WCSB averaged 57%, the lowest in four years, compared to 83% for the same quarter in 2005. Drilling rig utilization rates reflect an industry benchmark measure of oil and gas activity.

The increase in total assets in 2005 when compared to 2004 reflects the growth experienced by the Company's Oilfield Services segment combined with the added growth in operations provided by the Company's Energy Marketing segment.

During 2006, the Company repaid bank indebtedness of \$3,228,000 and long-term debt outstanding of \$3,048,000 at December 31, 2005. With the acquisition of Millard, the Company assumed Millard's debt obligations in the amount of \$1,835,000 and as at December 31, 2006 it has repaid debt obligations of Millard totaling \$1,548,000.

## Acquisition

On May 1, 2006, the Company acquired all of the outstanding common shares of Millard Trucking Ltd. and J.D.M. Trucking Ltd. ("Millard") for an aggregate purchase price of \$3,265,000.

Millard is a Sundre, Alberta based company involved in providing transportation services to the oil and gas industry. The operations of Millard Trucking Ltd. and J.D.M. Trucking Ltd. were amalgamated effective May 12, 2006 and have been continued under the name of Millard Trucking Ltd., as a wholly owned subsidiary of Enerchem. The results from operations of Millard are included in the Transportation Services segment.

This acquisition has been accounted for by the purchase method and the results of operations have been included in these consolidated financial statements from the date of acquisition. The cost of the purchase has been allocated to the acquired assets based on their estimated fair values at the date of the acquisition. Details of the acquisition are as follows:

As at May 1, 2006	\$
Current Assets	2,707,614
Property and equipment	4,521,000
Total assets acquired	7,228,614
Current liabilities	2,421,578
Long-term debt	848,408
Future income taxes	693,628
Total liabilities assumed	3,963,614
Net assets acquired	3,265,000
The consideration was by way of:	
Cash	2,733,000
100,000 common shares	532,000
	3,265,000

The value of the 100,000 common shares issued was determined based on the simple average of the closing prices of Enerchem's common shares on the Toronto Stock Exchange for the period near the date of acquisition.

## Discontinued Operations

On December 31, 2005, the Company sold its specialty chemical operations which included inventories and property, plant and equipment associated with these operations. The net gain on the sale of the discontinued operations amounted to \$3,747,000 after income taxes of \$1,484,000. Revenues from its discontinued operations were excluded from total revenues in the amount of \$15,789,000 for 2005. Details of the divestiture are provided in the notes to our audited financial statements under note 5, "Discontinued Operations".

## Results of Continuing Operations - Annual

### Consolidated Revenues

For the years ended December 31	2006		2005		Change
	\$	%	\$	%	%
Oilfield Services	75,667,971	70	72,072,308	66	5
Energy Marketing	25,423,192	24	37,059,971	34	(31)
Transportation Services	6,655,051	6	-	-	100
Total	107,746,214	100	109,132,279	100	(1)

While revenues from the Company's Oilfield Services business segment increased by 5% for the comparative periods and the operations of Millard, as reflected under the Transportation Services business segment, provided new revenue growth, consolidated revenues decreased by 1% as a result of the decline in the Company's Energy Marketing activities. During the second quarter of 2005, the third party facility used by the Energy Marketing segment in executing its activities was affected by a change of ownership which limited the operational flexibility previously available to this business segment.

## Segmented Revenues

### Oilfield Services

The Company's Oilfield Services segment is focused on manufacturing and selling its Specialty Fluids, comprised of three product categories: fracturing, drilling and solvent fluids. Oilfield Services' products are designed to provide measurable productivity increases, operating and maintenance cost reductions and solutions to environmental problems. The Oilfield Services' manufacturing facilities are situated in Sundre and Slave Lake, Alberta and are dedicated to providing proprietary Specialty Fluids and supporting services designed to ensure consistency in product quality to meet oil and gas processing and production requirements common to the WCSB.

### Oilfield Services - Product Revenues

For the years ended December 31	2006		2005		Change
	\$		\$		%
Fracturing	39,779,347		32,954,141		21
Drilling	22,789,470		22,482,392		1
Solvents	13,099,154		9,732,722		35
By-products - other	-		6,903,053		(100)
Total	75,667,971		72,072,308		5

The Oilfield Services segment achieved record revenues of \$75,668,000 in 2006, representing an increase of 5% over the previous year's record revenues. The increase in revenues during 2006 when compared to the prior year was largely influenced by record demand for the Company's manufactured products as the total volume of products sold increased by 4% and by implementing price increases in step with the underlying increase in feedstock costs. While drilling fluid revenues increased moderately year-over-year, we experienced less than anticipated drilling revenues and sales volumes largely as a result of the decline in drilling activity during the fourth quarter of 2006. Drilling rig utilization rates in the WCSB averaged 57% during the fourth quarter of 2006, the lowest in four years, compared to 83% for the same quarter last year. Unseasonably mild winter conditions combined with weak natural gas largely influenced the decline in drilling rig utilization rates. The improvement in Solvent revenues during 2006 when compared to 2005 resulted from the Company's continued success in marketing its products in specific regions of northern and central Alberta.

### Energy Marketing

During the third quarter of 2004, the Company diversified its operations with the establishment of its Energy Marketing group. This diversification was precipitated to maximize the value received by the Company for its hydrocarbon by-products, provide energy marketing management and expertise and to mitigate, in part, the Company's exposure to the seasonality of its operations. Upon commencement, the Company's Energy Marketing activities were conducted through a third party owned facility over which it was allowed to control the



purchasing, gathering and blending of its by-products with petroleum products acquired from third parties and the subsequent marketing of the blended petroleum for resale to refiners and other resellers. During the second quarter of 2005, this facility was affected by a change of ownership which limited the operational flexibility previously available to the Company's Energy Marketing segment. As a result, revenues from the Energy Marketing segment decreased by 31% in 2006 when compared to 2005 as its activities have been limited to maximizing the value received for the Company's by-product volumes and managing the Company's feedstock arrangements. The Company continues to pursue opportunities that will complement its energy marketing activities.

## Transportation Services

Revenues from the operations of Millard are earned by utilizing its fleet of commercial hauling vehicles and through the services provided by its arrangements with owner-operators. During the first eight months of operations, revenues from this segment totaled \$6,655,000, excluding inter-segment revenues of \$3,390,000, which represented 6% of consolidated revenues in 2006.

## Gross Profit

For the years ended December 31	2006	2005	Change
	\$	\$	%
Consolidated Gross Profit	20,869,487	16,674,725	25
% of Total Revenues	19%	15%	
Oilfield Services	14,281,231	12,494,996	14
% of Oilfield Services revenues	19%	17%	
Energy Marketing	3,537,940	4,179,729	(15)
% of Energy Marketing revenues	14%	11%	
Transportation Services	3,294,452	-	100
% of Transportation Services revenues	33%	-	
Net inter-segment services	(244,136)	-	(100)

Consolidated Gross Profit increased by 25% in 2006 when compared to 2005 as a result of initiatives undertaken by the Company to optimize its fluid transportation requirements and to minimize, when possible, the erosion of product margins during periods affected by increased feedstock costs. With the acquisition of Millard, the Company utilized the increase in its fluid transportation fleet for product deliveries previously provided by third party haulers. The foregoing initiatives contributed to the overall improvement in gross profit as a percentage of revenues for 2006 for the Oilfield Services and Energy Marketing business segments.

Inter-segment services in the above table represent fluid hauling services provided by Millard to the Oilfield Services and Energy Marketing business segments during the period. Transportation Services gross profit of \$3,294,000 for 2006 has been determined by deducting direct operating costs which includes the expenditures made to contractors and owner operators providing their services to Millard, fuel, fleet operating costs and the salaries and benefits of employed drivers.

## Operating Expenses

### Salaries and employee benefits

For the years ended December 31	2006	2005	Change
	\$	\$	%
Expense amount	5,097,386	4,892,698	4
% of gross profit margin	24%	29%	

The 4% increase in salary costs in 2006 when compared to 2005 resulted from the addition of operational staff at the Company's plant facilities and additional support staff associated with the Millard acquisition. Salaries and employee benefits associated with the truck drivers employed under the operations of Millard have been recorded as cost of sales.

## Selling, general and administration

For the years ended December 31	2006	2005	Change
	\$	\$	%
Expense amount	5,860,986	4,864,165	20
% of gross profit margin	28%	29%	

Selling, general and administration (SG&A) costs increased by 20% in 2006 when compared to 2005 largely as a result of the increase in general plant repairs and maintenance and plant turnaround costs associated with the Company's fractionation plants. Effective April 1, 2005, the Company implemented a scheduled turnaround maintenance program for its fractionation plants which requires the shutdown of its facilities for significant overhaul and refurbishment. For the year ended December 31, 2006, \$796,000 (December 31, 2005 - \$342,000) of turnaround costs were amortized and included in SG&A expense. In addition, a portion of the increase in comparative period SG&A expenditures was related to the acquisition of Millard and the increase in oilfield activity levels.

## Depreciation and amortization

For the years ended December 31	2006	2005	Change
	\$	\$	%
Depreciation	1,675,713	680,349	146
Amortization	2,446	8,675	(72)
Total amount	1,678,159	689,024	144
% of gross profit margin	8%	4%	

Depreciation and amortization expense increased by 144% in 2006 when compared to 2005 largely as a result of \$630,000 in depreciation expense associated with the acquired Millard assets. In addition, the increase in depreciation expense is attributable to the commencement with the depreciation of projects that were under construction at the Slave Lake plant at December 31, 2005 but completed in 2006 and the effects of a full year's depreciation in 2006 of projects completed and available for use at the Slave Lake plant during the latter part of 2005.

As at December 31, 2006, \$1,971,000 of costs associated with a flowback cleaning facility under construction in Sundre, Alberta have not been depreciated as the facility has not yet been completed and put in to use. The facility is scheduled for completion and commissioning in late March 2007. The total cost of the flowback cleaning facility is estimated at \$2,200,000.

## Income Taxes

For the years ended December 31	2006	2005	Change
	\$	\$	%
Expense amount	2,348,128	2,052,996	14
Effective tax rate	28%	35%	

The provision for income taxes in 2006 includes current taxes of \$2,542,000 compared to \$1,128,000 in 2005. The increase in current taxes in 2006 when compared to last year resulted from the increase in earnings.

The reduction in the effective tax rate in 2006 to 28% from 35% in 2005 resulted from the effects of recent substantively enacted changes in the Canadian Federal tax rates and the Alberta corporate tax rate over the next five years. The Federal tax rate reduction combined with the one time decrease in the Alberta corporate tax rate effective April 1, 2006 resulted in a statutory rate of 32.49% for 2006. This rate is scheduled to be reduced to 29% by 2010.

## Net Earnings

For the years ended December 31	2006	2005	Change
	\$	\$	%
Continuing operations	5,930,576	3,884,508	53
Earnings per share, diluted	0.39	0.26	50
EBITDA, continuing operations (1)	10,355,875	6,974,289	48
Discontinued operations	-	4,290,230	(100)
Earnings per share, diluted	-	0.29	(100)
Net earnings for the year	5,930,576	8,174,738	(27)
Earnings per share, diluted	0.39	0.55	(29)

(1) EBITDA is a non-GAAP measure which the Company defines as earnings before interest, taxes, depreciation, amortization, accretion expense and write-downs.



Net earnings from continuing operations for the year ended December 31, 2006 reflect a 53% increase over the previous year as a result of: the year-over-year growth in the volume of products sold which was largely influenced by the effects of strong activity levels in the WCSB during the first half of 2006; retail product pricing initiatives in step with changes in the underlying cost of feedstock; improved production yield from our fractionation plants combined with continued improvements in minimizing feedstock quality issues and plant downtime; benefits realized from the Millard acquisition; and the effects of reductions in Federal and Alberta corporate tax rates to be phased in over the next five years.

## Summary of Quarterly Results

The following tables provide selected unaudited financial information relating to the Company's quarterly activities in 2006 and 2005 and are prepared in accordance with Canadian generally accepted accounting principles with respect to the preparation of interim financial statements.

### 2006

#### Three month period ended

(unaudited)

	December 31	September 30	June 30	March 31
	\$	\$	\$	\$
Revenues	24,199,343	29,138,305	22,093,080	32,315,486
Net earnings from continuing operations	373,246	2,036,051	764,844	2,756,435
Net earnings per share from continuing operations				
Basic	0.02	0.13	0.05	0.19
Diluted	0.02	0.13	0.05	0.18
Net earnings for the period	373,246	2,036,051	764,844	2,756,435
Net earnings per share for the period				
Basic	0.02	0.13	0.05	0.19
Diluted	0.02	0.13	0.05	0.18

### 2005 <sup>(1)</sup>

#### Three month period ended

(unaudited)

	December 31	September 30	June 30	March 31
	\$	\$	\$	\$
Revenues	31,380,017	27,896,098	19,910,693	29,945,471
Net earnings from continuing operations	1,701,475	699,772	425,952	1,057,309
Net earnings per share from continuing operations				
Basic	0.11	0.05	0.03	0.07
Diluted	0.11	0.05	0.03	0.07
Net earnings for the period	5,586,835	850,722	336,239	1,400,942
Net earnings per share for the period				
Basic	0.37	0.06	0.02	0.10
Diluted	0.37	0.06	0.02	0.10

(1) The information for each of the first three quarters of 2005 has been restated to exclude discontinued operations.

Consolidated revenues and earnings from continuing operations increased during each of the first three quarters of 2006 when compared to the same periods in 2005 and reflected the effects of continued strong oil and gas activity levels in the WCSB up until late August 2006. The trend in revenues during the first nine months reflected the seasonality of the Company's operations with winter months traditionally being the Company's most active period and the period from late March through May traditionally being the slowest period. On May 1, 2006 the Company acquired the operations of Millard which provided the Company with new opportunities for revenue growth and cost reductions through its acquired transportation fleet. The Company's improvement in profitability for each quarter comprising the first nine months of 2006 when compared to the same quarters last year resulted from: retail product pricing initiatives in step with changes in the underlying cost of feedstock; improved production yield from our fractionation plants combined with continued improvements in minimizing feedstock quality issues and plant downtime; benefits realized from the Millard acquisition; and the effects of reductions in Federal and Alberta corporate tax rates to be phased in over the next five years.

During the fourth quarter of 2006, the Company experienced a decline in consolidated revenues and earnings from operations when compared to the same period last year as a result of the significant decline in oilfield activity levels in the WCSB which was largely influenced by the decline in oil prices and weakness in natural gas prices. The drop off in oilfield activity during the fourth quarter of 2006 precipitated a 17% decline in the volume of product sold by the Company when compared to the same period last year with the largest decline in product volumes affecting the Company's drilling fluids. During the fourth quarter of 2006 drilling rig utilization rates in the WCSB averaged 57%, the lowest in four years, compared to 83% for the same quarter last year. Drilling rig utilization rates reflect an industry benchmark measure of oil and gas activity levels.

## Liquidity and Capital Resources

Cash provided from continuing operations, before non-cash working capital items, for 2006 was \$8,665,000 compared to \$6,290,000 in 2005. The increase in cash flows was largely driven by the improvement in net earnings in 2006. As at December 31, 2006 the Company had positive working capital of \$20,650,000 compared to \$23,554,000 at December 31, 2005. During 2006, the Company used its cash resources to repay bank indebtedness and its long-term debt obligations under a credit facility with the bank and to acquire Millard. The Company's current ratio (defined as current assets divided by current liabilities) was 3.7 to 1 at December 31, 2006 compared to 2.2 to 1 at December 31, 2005. During 2006, the Company reduced its bank operating line of credit to \$5,500,000 from \$15,000,000, subject to margining requirements, to finance its working capital requirements and increased its bank guarantee facility to \$10,000,000 from \$5,000,000 to accommodate feedstock arrangements and purchase commitments with its suppliers. At December 31, 2006 the Company had outstanding bank guarantees of \$800,000 (December 31, 2005 - \$NIL). As at the date of this MD&A, the Company is in compliance with all debt covenants and obligations. The terms of the credit facility with the bank provide that non-revolving and revolving loans, while repayable on demand by the bank, will not be demanded by the bank unless the Company is in default of its obligations and covenants and if in the opinion of the bank there has been a change in the business, financial condition, operations or conduct of the Company. The Company believes that it has sufficient liquidity to operate its business and to execute its strategic plan.

Net cash used in investing activities from continuing operations were \$10,378,000 in 2006 compared to net cash provided of \$6,241,000 in 2005. Investing activities in 2006 included: cash expenditures of \$2,733,000 for the acquisition of Millard; \$7,446,000 for facilities improvement and expansion projects in Sundre and Slave Lake, Alberta; and equipment purchases for Millard. During 2005, investing activities included proceeds of \$10,204,000 from the sale of property, plant and equipment related to the discontinued operations. Capital expenditures during the current year were funded from proceeds received on the sale of the Company's discontinued operations and operating cash flows.

Net cash used in financing activities from continuing operations were \$7,145,000 in 2006 compared to \$909,000 in 2005. Proceeds from the issuance of common shares upon exercise of stock options were \$1,147,000 in 2006 compared to \$293,000 in 2005. During 2006, the Company repaid its long-term debt outstanding of \$3,048,000 at December 31, 2005. With the acquisition of Millard, the Company assumed Millard's debt obligations in the amount of \$1,835,000 and at December 31, 2006 has repaid debt obligations of Millard totaling \$1,548,000.

## Summary of Contractual Obligations and Off-Balance Sheet Arrangements

The following table summarizes the Company's contractual obligations including payments due for each of the next five years and thereafter.

Contractual obligations (in Canadian dollars)	Total	Payments due by period			
		Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
	\$	\$	\$	\$	\$
Finance contract loans (1)	287,062	115,585	150,081	21,396	-
Operating leases (2)	553,457	265,797	287,660	-	-
Total contractual obligations	840,519	381,382	437,741	21,396	-

(1) Represents debt obligations assumed by the Company with the acquisition of Millard with specific equipment pledged as collateral. The loans are repayable in blended monthly payments of \$10,662 and mature at varying dates from April 2008 to August 2010.

(2) Represents normal operating leases comprised of vehicles, trailers and office space.



In the normal course of business with vendors the Company may become contingently liable for performance under letters of guarantee and credit. In this regard, the Company has arranged a \$10,000,000 bank guarantee facility available as security for its feedstock arrangements and purchase commitments. At December 31, 2006 the Company had provided an \$800,000 letter of guarantee, which terminated January 2007, in favour of a supplier for the purchase of petroleum feedstock from that company.

For 2006 the Company expects cash flow from operations and from its sources of financing to be sufficient to meet its contractual obligations and off-balance sheet arrangements.

## Share Capital

As at December 31, 2006 the Company had 15,295,307 common shares outstanding. In addition, as at that date the Company has reserved 534,000 common shares for issuance under outstanding stock options.

## Results of Continuing Operations - Fourth Quarter

The following unaudited interim financial statements reflect the results of operations for the three months ended December 31, 2006 and 2005.

Three months ended December 31	2006	2005
	\$	\$
Revenues	24,199,343	31,380,017
Cost of sales	20,036,837	25,611,786
Gross profit	4,162,506	5,768,231
Expenses		
Salaries and employee benefits	1,304,961	1,131,669
Selling, general and administration	1,502,071	1,731,309
Depreciation and amortization	533,000	201,873
Amortization of pre-operating costs	21,718	21,718
Accretion expense	2,964	1,100
Interest expense	23,652	55,738
	3,388,366	3,143,407
Earnings from continuing operations before other expense	774,140	2,624,824
Other expense	50,222	9,520
Earnings from continuing operations before income taxes	723,918	2,615,304
Income taxes	350,672	913,829
Net earnings from continuing operations	373,246	1,701,475
Net earnings from discontinued operations	-	3,885,360
Net earnings for the period	373,246	5,586,835

### Consolidated Revenues

Three months ended December 31	2006		2005		Change
	\$	%	\$	%	%
Oilfield Services	16,623,413	69	21,050,928	67	(21)
Energy Marketing	4,751,770	20	10,329,089	33	(54)
Transportation Services	2,824,160	11	-	-	100
Total	24,199,343	100	31,380,017	100	(23)

Consolidated revenues declined by 23% during the fourth quarter of 2006 when compared to the same period last year as a result of the significant decline in oilfield activity levels in the WCSB which was largely influenced by the weakness in natural gas prices. While the Transportation Services business segment provided new revenue growth of \$2,824,000 during the fourth quarter of 2006, revenues from the Energy Marketing business segment declined by 54% on a comparative quarter basis as a result of the decline in the Company's production activity levels.

## Segmented Revenues

### Oilfield Services - Product Revenues

Three months ended December 31	2006	2005	Change
	\$	\$	%
Fracturing	9,298,647	10,267,064	(9)
Drilling	4,109,936	8,050,516	(49)
Solvents	3,214,830	2,733,348	18
Total	16,623,413	21,050,928	(21)

Revenues from the Oilfield Services segment decreased by 21% for the fourth quarter of 2006 when compared to the same period last year. The drop off in oilfield activity during the fourth quarter of 2006 precipitated a 17% decline in the volume of product sold by the Company when compared to the same period last year with the largest decline in product volumes affecting the Company's drilling fluids. During the fourth quarter of 2006 drilling rig utilization rates in the WCSB averaged 57%, the lowest in four years, compared to 83% for the same quarter last year. The 9% decline in fracturing fluid revenues during the fourth quarter of 2006 when compared to the same period last year largely resulted from the Company discontinuing its distribution arrangements for the selling of third party produced fracturing fluids. The Company's termination of these arrangements resulted from concerns over product quality and availability. The improvement in Solvent revenues on a comparative quarter basis resulted from the Company's continued success in marketing its products in specific regions of northern and central Alberta.

### Energy Marketing

For the three months ended December 31, 2006, revenues from the Energy Marketing segment decreased by 54% when compared to the same period last year as a result of the decline in activity levels which reduced the volume of by-products available for re-sale and the overall decline in crude oil prices on a comparative quarter basis which caused a decline in the ending value received for the Company's by-products. During the comparative fourth quarters of 2006 and 2005, all of the Company's by-products produced at the Sundre and Slave Lake plants were available for this segment's activities. The Company continues to pursue opportunities that will complement its energy marketing activities.

### Transportation Services

Transportation Services revenues for the three months ended December 31, 2006 totaled \$2,824,000, excluding inter-segment revenues of \$1,142,000. Revenues from this segment represented 11% of consolidated revenues for the fourth quarter of 2006. During the fourth quarter of 2006, revenues from this business segment, excluding inter-segment revenues, increased by 28% when compared to the three months ended September 30, 2006.

## Gross Profit

Three months ended December 31	2006	2005	Change
	\$	\$	%
Consolidated Gross Profit	4,162,506	5,768,231	(28)
% of Total Revenues	17%	18%	
Oilfield Services	2,558,139	4,329,469	(41)
% of Oilfield Services revenues	15%	21%	
Energy Marketing	599,523	1,438,762	(58)
% of Energy Marketing revenues	13%	14%	
Transportation Services	1,023,078	-	100
% of Transportation Services revenues	26%	-	
Net inter-segment services	(18,234)	-	(100)

Consolidated Gross Profit decreased by 28% during the fourth quarter of 2006 when compared to the same period in the prior year due to the overall decline in oilfield activity levels. Consolidated gross profit as a percent of consolidated revenues declined to 17% from 18% for the comparative quarters as industry competitiveness increased with the slowdown in activity.



Oilfield Services gross profit as a percent of Oilfield Services revenues declined to 15% from 21% for the comparative periods and reflects the effects of competitive pricing pressures precipitated by the slowdown in activity levels combined with the effects of an unanticipated 8% increase in feedstock costs from November to December 2006 which represented a period during which the Company continued to soften its retail product prices.

Inter-segment services in the above table represent fluid hauling services provided by Millard to the Oilfield Services and Energy Marketing business segments during the period. Transportation Services gross profit of \$1,023,000 for the three months ended December 31, 2006 has been determined by deducting direct operating costs which includes the expenditures made to contractors and owner operators providing their services to Millard, fuel, fleet operating costs and the salaries and benefits of employed drivers.

## Operating Expenses

### Salaries and employee benefits

Three months ended December 31	2006	2005	Change
	\$	\$	%
Expense amount	1,304,961	1,131,669	15
% of gross profit margin	31%	20%	

The 15% increase in salary costs on a comparative quarter basis resulted from the addition of operational and support staff at the Company's facilities and support staff acquired through the Millard acquisition. The increase in salary costs on a comparative quarter basis also reflects employee performance awards associated with the Company's employee bonus plan.

### Selling, general and administration

Three months ended December 31	2006	2005	Change
	\$	\$	%
Expense amount	1,502,071	1,731,309	(13)
% of gross profit margin	36%	30%	

SG&A costs declined by 13% for the quarter ended December 31, 2006 when compared to the same period in 2005. The decrease in SG&A expenditures resulted from expensing all fuel and operating costs associated with the Transportation Services business segment to cost of sales and the reduction in consulting services utilized by the Energy Marketing business segment.

### Depreciation and amortization

Three months ended December 31	2006	2005	Change
	\$	\$	%
Depreciation	533,000	199,704	167
Amortization	-	2,169	(100)
Total amount	533,000	201,873	164
% of gross profit margin	13%	3%	

Depreciation and amortization expense increased by 164% in 2006 when compared to 2005 largely as a result of \$267,000 in depreciation expense associated with the acquired Millard assets. In addition, the increase in depreciation expense is attributable to the commencement with the depreciation of projects that were under construction at the Slave Lake plant at December 31, 2005 and completed in 2006 and the effects of a full year's depreciation in 2006 of projects completed and available for use at the Slave Lake plant during the latter part of 2005.

As at December 31, 2006, \$1,971,000 of costs associated with a flowback cleaning facility under construction in Sundre, Alberta have not been depreciated as the facility has not yet been completed and put in to use. The facility is scheduled for completion and commissioning in late March 2007. The total cost of the flowback cleaning facility is estimated at \$2,200,000.

## Net Earnings

Three months ended December 31	2006	2005	Change
	\$	\$	%
Continuing operations	373,246	1,701,475	(78)
Earnings per share, diluted	0.02	0.11	(82)
EBITDA, continuing operations (1)	1,535,252	2,895,733	(47)
Discontinued operations	-	3,885,360	(100)
Earnings per share, diluted	-	0.26	(100)
Net earnings for the period	373,246	5,586,835	(93)
Earnings per share, diluted	0.02	0.37	(95)

(1) EBITDA is a non-GAAP measure which the Company defines as earnings before interest, taxes, depreciation, amortization, accretion expense and write-downs.

Net earnings from continuing operations for the three months ended December 31, 2006 declined by 78% to \$373,000 from \$1,701,000 for the same period last year as a result of the slowdown in activity levels precipitated by weak natural gas prices. The drop off in oilfield activity during the fourth quarter of 2006 resulted in a 19% decline in the volume of product sold by the Company when compared to the same period last year with the largest decline in product volumes affecting the Company's drilling fluids. During the fourth quarter of 2006 drilling rig utilization rates in the WCSB averaged 57%, the lowest in four years, compared to 83% for the same quarter last year.

The Company's 47% decrease on EBITDA from continuing operations during the fourth quarter of 2006 when compared to the previous quarter last year resulted from the 78% decline in earnings.

## Critical Accounting Policies

The Company's financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include estimates that reflect management's estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and revenue and expenses for the period reported. Estimates are based upon historical experience and various other assumptions that reflect management's best judgments. These estimates are evaluated periodically and form the basis for making judgments regarding the carrying values of assets and liabilities and the reported amount of revenue and expenses. Actual results could differ from these estimates.

The following discussion outlines the accounting policies and practices and management's estimates that are critical to determining Enerchem's financial results.

### Goodwill Impairment

The Company tests goodwill for impairment annually and whenever events or circumstances make it more likely than not that an impairment may have occurred, such as a significant adverse change in the business climate or a decision to sell or dispose of a reporting unit. Determining whether impairment has occurred requires valuation of the respective reporting unit, which is estimated using discounted cash flow methodology. When available and as appropriate, comparative market multiples are used to corroborate discounted cash flow results. In applying this methodology, a number of factors are relied upon, including actual operating results, future business plans, economic projections and market data. During the year, management performed its annual evaluation of the carrying value of goodwill and concluded that goodwill of its reporting units was not impaired.

### Property, Plant and Equipment

Property, plant and equipment ("PP&E") are recorded at cost and are depreciated over their estimated useful lives on a declining balance basis, except for the fractionation processing facilities which are depreciated on a straight-line basis. Judgment is involved in determining the useful life of the PP&E and the appropriate annual depreciation rate. The Company's investment in PP&E results in depreciation expense being a significant component of operating expenses of the Company and any misjudgment in determining the useful life and annual depreciation rate could result in a misstatement of depreciation expense.

### Income Taxes

The provision for income taxes is calculated based on the expected tax treatment of transactions recorded in the Company's financial statements. Income tax assets and liabilities, both current and future, are measured according to the income tax legislation that is expected to apply when the asset is realized or when the liability settled. If the Company's interpretations differ from those of tax authorities or judgments with respect to tax losses change, the income tax provision could increase or decrease, potentially significantly, in future periods.



## Changes in Accounting Policies and Practices

### Accounting by a Vendor for Consideration Given to a Customer

Effective October 1, 2006, the Company adopted the recommendations of the CICA EIC 156, "Accounting by a Vendor for Consideration Given to a Customer", which provides guidance on the accounting treatment and classification of sales incentives or other consideration that are offered by a vendor to direct or indirect customers. The guideline requires that any sales incentives or other consideration provided to a customer should be recorded as a reduction of revenue or, when certain conditions are met, as a sales operating expense. We provide certain customers with sales incentives that are based on their achieving Company defined purchase quotas.

## Future Changes in Accounting Policies

The Accounting Standards Board has issued new accounting standards for financial instruments that comprehensively address when an entity should recognize a financial instrument on its balance sheet, or how it should measure the financial instrument once recognized. The new standards comprise three sections of the CICA handbook:

- a) CICA Section 3855, "Financial Instruments-Recognition and Measurement", establishes the criteria for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. It also specifies how financial instrument gains and losses are to be presented. The impact of the adoption of this new section on the consolidated financial statements is not expected to be material.
- b) CICA Section 3865, "Hedges", provides optional alternative treatments to CICA Section 3855 for entities which choose to designate qualifying transactions as hedges for accounting purposes. It will replace AcG-13, "Hedging Relationships", and build on CICA Section 1650, "Foreign Currency Translation", by specifying how hedge accounting is applied and what disclosures are necessary when CICA Section 3865 is applied. The impact of the adoption of this new section on the consolidated financial statements is not expected to be material.
- c) CICA Section 1530, "Comprehensive Income", establishes standards for the reporting and display of comprehensive income. These standards require that an entity present comprehensive income and its components in a separate financial statement that is displayed with the same prominence as other financial statements.

These standards will be effective for the Company as of January 1, 2007 and will be adopted on a retroactive without restatement basis.

## Financial Instruments and Other Instruments

### Fair Values

The carrying values of cash and cash equivalents, accounts receivable, promissory note, bank indebtedness and accounts payable and accrued liabilities approximate their fair value due to the relatively short periods to maturity on these instruments. The fair value of the Company's long-term debt is estimated based on market prices for same or similar instruments and approximates carrying value.

### Credit Risk

The Company's Oilfield Services segment's revenues are predominantly from services provided to large oil and gas companies which may result in a significant exposure to one customer or on a combined basis to several individual customers. The Company's Energy Marketing revenues are attributable to several large oil & gas producers and oilfield services companies which account for all of this segment's revenues. Concentration of credit risk on the Company's trade accounts receivable exists in the oil and gas industry. The Company's management regularly reviews outstanding accounts receivable and follows up with customers when settlement has not occurred on a timely basis. Management believes that the Company is exposed to minimal credit risk since the majority of its business is conducted with companies that have a large market presence in the industry and or are large publicly held companies.

### **Petroleum Prices**

The Company is exposed to changes in petroleum and natural gas prices as a result of its use of petroleum feedstock and natural gas for processing at its Sundre and Slave Lake fractionation plants. The potential fluctuations in petroleum and natural gas prices could have a significant impact on the cost of producing the Company's products and its profitability. To mitigate the affects on profitability of upward changes in petroleum prices, the Company implements product price increases to reflect their underlying values. This ability, however, is sensitive to competitive product pressures. In addition, this risk is reduced in part, from time to time, through the use of crude oil and natural gas forward purchase contracts. The contracts are not used for speculative trading purposes. Realized gains or losses on these contracts are reported as adjustments to petroleum and natural gas costs in the related production period.

As at December 31, 2006 and 2005 the Company did not have any outstanding crude oil and natural gas forward purchase contracts.

### **Interest Rate Risk**

The Company manages its interest rate risk on borrowings by utilizing a combination of short term fixed rates, through the use of 30 to 90 day Bankers' Acceptance rates, and floating rates on debt. As at December 31, 2006, the Company did not have amounts outstanding under its available credit facility with the bank. At December 31, 2005 bank indebtedness represented the Company's use of its available demand operating line of credit.

### **Health, Safety and Environmental**

The Company has achieved and maintained a Certificate of Recognition which is given to employers who develop health and safety programs to meet standards established by the Petroleum Industry Training Service and Alberta Human Resources and Employment. The Company has safety and environmental personnel responsible for maintaining and developing the Company's policies and monitoring the Company's operations to ensure compliance with established policies. However, there can be no assurances that the Company's procedures will prevent environmental damage occurring from spills of materials handled by the Company. The safety and environmental personnel report directly to the President and Chief Executive Officer of the Company.

### **Competition and Industry Conditions**

The capital expenditure programs of oil and gas companies largely affect the services provided by the Company. The magnitude of capital expenditures determines the demand for the Company's services in providing hydrocarbon fluid solutions to the oil and gas production industry. The primary catalysts to high expenditures and activity levels in the energy industry are oil and gas prices which, in turn, are influenced strongly by supply and demand expectations. The ability to forecast the price of crude oil or natural gas is extremely difficult as many global factors affecting commodity prices are beyond the control of the Company.

There is a strong correlation between drilling activity and demand for the Company's hydrocarbon fracturing and drilling fluids. Industry demand for the Company's fracturing and drilling products is further determined by activity levels that are focused on deep well drilling and applications common to the foothills region and northern Alberta and British Columbia, areas known for deeper drilling. Oil and gas activity in these geographic regions is normally strong during winter months or other times when climatic conditions are favourable. In addition, as our Specialty Fluids and services are sold in highly competitive markets, the Company's revenues and earnings can be affected by changes in competitive prices and new technologies and methods.

### **Operating Risk and Insurance**

Enerchem has an insurance and risk management program in place to protect its assets, operations and employees. The Company's operations are, however, subject to risks inherent in the oil and gas industry such as malfunction and failures and natural disasters with resultant fluid spills, explosions and fires. These risks could expose the Company to substantial liability for personal injury, loss of life, business interruption, property damage or destruction, pollution and other environmental damages. Although the Company has obtained insurance against certain of the risks to which it is exposed, such insurance is subject to coverage limits and no assurance can be given that such insurance will be adequate to cover the Company's liabilities or will be generally available in the future or, if available, that premiums will be commercially justifiable. If the Company were to incur substantial liability and such damages were not covered by insurance or were in excess of policy limits, its business, results of operations and financial condition could be materially adversely affected.



## Disclosure Controls and Internal Controls Over Financial Reporting

Multilateral Instrument 52-109, "Certification of Disclosure in Issuers' Annual and Interim Filings", issued by the Canadian Securities Administrators requires the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") to certify that they are responsible for establishing and maintaining disclosure controls and procedures for the issuer, that disclosure controls and procedures have been designed to provide reasonable assurance that material information relating to the issuer is made known to them, that they have evaluated the effectiveness of the issuer's disclosure controls and procedures, and that their conclusions about the effectiveness of those disclosure controls and procedures at the end of the period covered by the relevant annual filings have been disclosed by the issuer.

Enerchem's CEO and CFO have evaluated the effectiveness of the Company's disclosure controls and procedures as at December 31, 2006 and have concluded that its disclosure controls and procedures were effective for the year then ended.

In addition, an evaluation of the design of internal controls over financial reporting was conducted as of December 31, 2006 by and under the supervision of management, including the CEO and CFO. Based on this evaluation, the CEO and CFO have concluded that internal controls and procedures, defined under Multilateral Instrument 52-109, have been designed to reasonably ensure the reliability of financial reporting and that the preparation of financial statements for external purposes are in accordance with those rules. Management also concluded that during the quarter ended December 31, 2006, no changes were made to internal controls over financial reporting that would have materially affected, or would be reasonably considered to materially affect, these controls.

## Management's Responsibility

The management of Enerchem International Inc. is responsible for the preparation of the accompanying consolidated financial statements and the preparation of all information in the annual report. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada and are considered by management to present fairly the financial position and operating results of the Company.

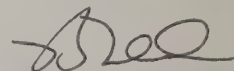
The Company maintains various systems of internal control to provide reasonable assurance that transactions are appropriately authorized and recorded, that assets are safeguarded and that financial records are properly maintained to provide accurate and reliable financial statements.

The Board of Directors of the Company carries out its responsibility for the financial statements through its Audit Committee. The Audit Committee has and will meet periodically with the Company's management and independent auditors to review financial reporting matters and internal controls and to review the consolidated financial statements. The Audit Committee reported its findings to the Board of Directors who have approved the consolidated financial statements.

The Company's independent auditors, PricewaterhouseCoopers LLP, Chartered Accountants, have examined the consolidated financial statements whose findings are contained in this annual report.



Douglas F. Robinson  
President & Chief Executive Officer



Brian M. Zubach, CMA  
Chief Financial Officer

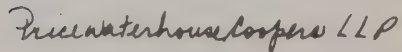
## Auditors' Report

To the Shareholders of  
Enerchem International Inc.

We have audited the consolidated balance sheets of Enerchem International Inc. as at December 31, 2006 and 2005 and the consolidated statements of operations and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



PricewaterhouseCoopers LLP  
Chartered Accountants

Edmonton, Canada  
March 19, 2007



## Consolidated Balance Sheets

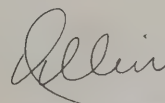
As at December 31

	2006	2005
	\$	\$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	2,413,522	10,974,739
Accounts receivable	16,386,688	22,621,022
Inventories	9,288,729	9,434,930
Prepaid expenses	197,533	144,674
Current portion of promissory note	61,127	122,354
	28,347,599	43,297,719
<b>Promissory note</b>	-	61,186
<b>Other assets</b> (note 7)	1,279,903	1,475,109
<b>Property, plant and equipment</b> (note 6)	32,877,523	23,037,461
<b>Goodwill</b> (note 1(f))	6,049,530	6,049,530
	68,554,555	73,921,005
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank indebtedness (note 8)	-	3,228,132
Accounts payable and accrued liabilities	7,258,179	13,203,125
Income taxes payable	323,709	2,097,000
Current portion of long-term debt (note 9)	115,585	1,215,488
	7,697,473	19,743,745
<b>Long-term debt</b> (note 9)	171,477	1,832,276
<b>Asset retirement obligations</b> (note 10)	192,301	180,292
<b>Future income taxes</b> (note 13)	4,439,707	3,940,000
	12,500,958	25,696,313
<b>Contingent liabilities</b> (note 17)		
<b>Shareholders' equity</b>		
Share capital (note 11)	29,675,698	27,973,843
Contributed surplus (note 11(c))	1,123,673	927,199
Retained earnings	25,254,226	19,323,650
	56,053,597	48,224,692
	68,554,555	73,921,005

Signed on behalf of the Board,



Larry B. Phillips  
Director



Kenneth A. Klein  
Director

The accompanying notes are an integral part of these consolidated financial statements.

## Consolidated Statement of Operations and Retained Earnings

For the years ended December 31	2006	2005
	\$	\$
<b>Revenues</b>	107,746,214	109,132,279
<b>Cost of sales</b>	86,876,727	92,457,554
<b>Gross profit</b>	20,869,487	16,674,725
<b>Expenses</b>		
Salaries and employee benefits	5,097,386	4,892,698
Selling, general and administration	5,860,986	4,864,165
Depreciation and amortization	1,678,159	689,024
Amortization of pre-operating costs	86,871	86,871
Accretion expense (note 10)	12,009	10,972
Interest expense (note 12)	70,132	249,918
	12,805,543	10,793,648
<b>Earnings from continuing operations before other income (expense)</b>	8,063,944	5,881,077
<b>Other income (expense)</b>		
Gain (loss) on disposal of property, plant and equipment	94,913	(24,008)
Write-down of investment in foreign operations (note 7(a))	(230,000)	-
Interest income and other	349,847	-80,435
	214,760	56,427
<b>Earnings from continuing operations before income taxes</b>	8,278,704	5,937,504
<b>Income taxes (note 13)</b>		
Current	2,542,049	1,127,577
Future	(193,921)	925,419
	2,348,128	2,052,996
<b>Net earnings from continuing operations</b>	5,930,576	3,884,508
<b>Net earnings from discontinued operations (note 5)</b>	-	4,290,230
<b>Net earnings for the year</b>	5,930,576	8,174,738
<b>Retained earnings, beginning of year</b>	19,323,650	11,148,912
<b>Retained earnings, end of year</b>	25,254,226	19,323,650
<b>Basic earnings per share (note 11(e))</b>		
Continuing operations	0.39	0.26
Discontinued operations	-	0.29
<b>Net earnings per share</b>	0.39	0.55
<b>Diluted earnings per share (note 11(e))</b>		
Continuing operations	0.39	0.26
Discontinued operations	-	0.29
<b>Net earnings per share</b>	0.39	0.55
<b>Weighted average shares outstanding (note 11(e))</b>		
Basic	15,171,836	14,793,712
Diluted	15,362,673	14,796,030

The accompanying notes are an integral part of these consolidated financial statements.



# Consolidated Statement of Cash Flows

For the years ended December 31	2006	2005
	\$	\$
<b>Operating activities</b>		
Net earnings from continuing operations	5,930,576	3,884,508
Items not affecting cash -		
Depreciation, amortization and accretion expense	1,777,039	778,192
Stock based compensation	219,599	335,768
Amortization of plant turnaround costs	796,312	342,172
(Gain) loss on disposal of property, plant and equipment	(94,913)	24,008
Write-down of investment in foreign operations	230,000	-
Future income taxes	(193,921)	925,419
	8,664,692	6,290,067
Changes in non-cash components of working capital		
Net change in accounts receivable	8,845,234	(5,188,752)
Net change in inventories and prepaid expenses	137,019	(3,767,499)
Net change in accounts payable and accrued liabilities	(6,599,416)	826,837
Net change in income taxes payable	(2,086,334)	1,127,577
	296,503	(7,001,837)
Net cash provided by (used in) continuing operations	8,961,195	(711,770)
Net cash provided by discontinued operations (note 15)	-	4,111,436
Net cash provided by operating activities	8,961,195	3,399,666
<b>Investing activities</b>		
Purchase of property, plant and equipment	(7,445,814)	(3,690,751)
Acquisition of subsidiary operations (note 4)	(2,733,000)	-
Cash acquired on acquisition of subsidiary operations	53,037	-
Decrease in promissory note	122,413	131,374
Proceeds from disposal of property, plant and equipment	545,958	103,360
Proceeds from sale of specialty chemical operations (note 5)	-	10,203,817
Increase in other assets	(920,424)	(507,017)
Net cash (used in) provided by investing activities, continuing operations	(10,377,830)	6,240,783
Net cash used in investing activities, discontinued operations	-	(351,477)
Net cash (used in) provided by investing activities	(10,377,830)	5,889,306
<b>Financing activities</b>		
Issuance of common shares	1,146,730	507,872
Decrease in bank indebtedness	(3,695,148)	(248,812)
Repayment of long-term debt	(4,596,164)	(1,167,957)
Net cash used in financing activities	(7,144,582)	(908,897)
<b>(Decrease) increase in cash and cash equivalents</b>	<b>(8,561,217)</b>	<b>8,380,075</b>
<b>Cash and cash equivalents - beginning of year</b>	<b>10,974,739</b>	<b>2,594,664</b>
<b>Cash and cash equivalents - end of year</b>	<b>2,413,522</b>	<b>10,974,739</b>

Supplementary information (note 14)

The accompanying notes are an integral part of these consolidated financial statements.

# Notes to Consolidated Financial Statements

## For the years ended December 31, 2006 and 2005

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### 1. Summary of significant accounting policies

#### (a) Basis of presentation

These consolidated financial statements of Enerchem International Inc. ("Enerchem" or the "Company") are prepared in accordance with generally accepted accounting principles ("GAAP") in Canada. In the opinion of management, all adjustments which are of normal and recurring nature necessary for a fair presentation of the balance sheet, results of operations and cash flows of these annual statements, have been included.

These consolidated financial statements include the accounts of the parent company and its wholly owned subsidiary Millard Trucking Ltd. ("Millard"). All significant inter-company balances and transactions have been eliminated. On December 31, 2005, the Company sold the inventory and property, plant and equipment associated with its specialty chemical operations. Accordingly, the specialty chemical operating activities have been reported as discontinued operations for the comparative year ended December 31, 2005. The discontinued operations are more fully described in note 5.

#### (b) Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### (c) Cash and cash equivalents

Cash and cash equivalents consist of cash on deposit and short-term interest bearing securities with maturities of less than three months.

#### (d) Inventories

Inventories are carried at the lower of average cost and estimated net realizable value. For finished goods inventory, cost includes direct labour and an allocation of overhead that can be attributed to production.

The Company allocates feedstock costs to its products and by-products that are produced simultaneously in the same processing operation through the relative sales value method. Under this method, joint product costs are allocated based on each product's percentage of the total sales value of all products produced. This method results in the same gross profit percentage for each joint or common product produced. Under this method revenues from the sale of the Company's by-products are recorded as revenue with the corresponding cost of by-products sold, as determined under the relative sales value method, recorded as a cost of sales.

#### (e) Property, plant and equipment

Property, plant and equipment are recorded at cost and are depreciated over their estimated useful lives at the following annual rates:

Buildings and blend plant facilities	5% to 20% declining balance
Laboratory equipment	10% declining balance
Oilfield equipment	10% declining balance
Fractionation processing facilities	straight-line method (described below)
Leasehold improvements	10% to 20% declining balance
Automotive equipment	30% declining balance
Oilfield trailers	10% declining balance
Office, computer equipment and software	20% to 100% declining balance



## 1. Summary of significant accounting policies (continued)

### (e) **Property, plant and equipment** (continued)

The Company depreciates its fractionation facilities on a straight-line basis over the plants' expected useful lives which range from 29 to 37 years. The Company has also established estimated salvage values for these facilities based on accepted industry standards. A salvage value of \$750,000 has been established for the Slave Lake facility and \$250,000 has been established for the Sundre facility.

### (f) **Goodwill**

Goodwill represents the excess of the cost of business acquisitions over the fair value of net identifiable assets acquired. Goodwill is not amortized but is tested for impairment annually or more frequently if changes in circumstances indicate a potential impairment. Management has performed its annual evaluation of the carrying value of goodwill and concluded that the goodwill associated with its reporting units was not impaired.

### (g) **Investment in foreign operations**

The Company's investment in foreign operations is recorded at cost unless there is a decline in value that is other than temporary. Earnings from this investment will be recognized only to the extent received or receivable.

### (h) **Future income taxes**

Income taxes are calculated using the liability method of accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using substantively enacted tax rates anticipated to apply in periods that the temporary differences are expected to reverse. The effect on future income tax liabilities and assets of a change in the tax rate is recognized in income in the period that the change occurs.

### (i) **Revenue recognition**

Revenues associated with sales of the Company's chemical and hydrocarbon fluids are recorded in the period in which the fluids are delivered to the customer, the customer has taken title, assumed the risks and rewards of ownership, amounts are known and collection is reasonably assured. Revenues associated with the services provided by Millard are recognized when its services have been provided to and accepted by the customer and collectibility is reasonably assured.

### (j) **Turnaround maintenance costs**

The Company has a scheduled turnaround maintenance program for its fractionation plants which requires the shutdown of its facilities for significant overhaul and refurbishment. The Company expects to execute its scheduled turnaround program during the second quarter of each year. Costs of major fractionation plant maintenance are charged to operations over a one year period. At December 31, 2006 unamortized turnaround costs in the amount of \$297,631 (December 31, 2005 - \$173,520) are included in other assets. For the year ended December 31, 2006, \$796,312 (December 31, 2005 - \$342,172) of turnaround costs were amortized and included in selling, general and administration expense. Normal repairs and maintenance to the fractionation plants are expensed as incurred.

### (k) **Earnings per share**

Basic earnings per common share are calculated based on the average number of common shares outstanding during the year. Diluted earnings per share are calculated based on the treasury stock method which assumes that any proceeds from the exercise of in the money stock options would be used to purchase the Company's common shares at the average market price during the year. The computation of diluted earnings per share is similar to basic earnings per share except that the weighted average number of shares outstanding is increased to include additional shares from the assumed exercise of stock options, if dilutive.

### (l) **Stock based compensation**

The Company has adopted the recommendations of the Canadian Institute of Chartered Accountants' ("CICA") Handbook Section 3870 "Stock Based Compensation and Other Stock Based Payments" which requires the expensing of all stock based compensation awards using a fair value based method of accounting for fiscal years beginning after January 1, 2004. Under the fair value method, compensation expense equal to the fair value of stock options granted is recorded in the statement of operations over the vesting period. The Company's stock based compensation plans are described in note 11.

## 1. Summary of significant accounting policies (continued)

### (m) Pre-operating costs

Pre-operating costs incurred during the start-up of the Company's fractionation plant in Slave Lake, Alberta were capitalized until the plant was capable of consistently providing its intended commercial service. These costs are being amortized over a period of five years which commenced on January 1, 2003.

### (n) Incentive plan for senior management

The Company implemented an incentive program for designated senior management employees to reward their efforts in achieving the Company's performance objectives. The term of the plan was for two years ending December 31, 2006. The incentive program provided for a bonus payment based on the amount by which the Company's common share price, based on a weighted averaged share price, exceeded \$5.00 per share as of December 31, 2005 and 2006. During 2006 and 2005, the Company's common share performance targets were not achieved, and as a result, the Company did not incur or accrue incentive payments under the plan. Subsequent to December 31, 2006, the plan was not renewed.

### (o) Asset retirement obligations

Obligations associated with the retirement of tangible long-lived assets and associated retirement costs are recognized in the period in which a reasonable estimate of fair value can be made by recording a liability at a discounted fair value for the future abandonment and restoration associated with the properties. The fair value of the liability is capitalized as part of the cost of the related asset and amortized to expense over its useful life. The liability accretes until the date of expected settlement of the retirement obligation. The related accretion expense is recognized in the statement of operations. The provision is revised for any changes to timing related to cash flow or undiscounted abandonment costs. Actual expenditures incurred for the purpose of site restoration are charged to the asset retirement obligations to the extent that the liability exists on the balance sheet. Differences between the actual costs incurred and the fair value of the liability recorded are recognized to earnings in the period incurred.

### (p) Conditional asset retirement obligations

Effective April 1, 2006, the Company adopted the recommendations of the CICA EIC 159, "Conditional Asset Retirement Obligations". In accordance with these recommendations, legal obligations to perform an asset retirement activity in which the timing or method of settlement are conditional on a future event that may not be within the control of the Company should be recorded at fair value as soon as fair value can be reasonably estimated. In situations where the fair value of a conditional asset retirement obligation cannot be reasonably estimated, that fact and reasons are to be disclosed. The recommendations of EIC 159 are effective for interim and annual reporting periods after March 31, 2006 and are to be applied retroactively, with restatement of all prior periods.

The Company has determined that it has no conditional asset retirement obligations at December 31, 2006.

### (q) Impairment of long-lived assets

The Company tests long-lived assets when events or changes in circumstances occur which may cause their carrying value to exceed the total undiscounted cash flows expected from their use and eventual disposition. An impairment loss, if any, is determined as the excess of the carrying value of the asset over its fair value.

### (r) Consolidation of variable interest entities

The Company adopted the CICA issued Accounting Guideline 15, Consolidation of Variable Interest Entities which became effective for annual and interim periods beginning on or after November 1, 2004. A Variable Interest Entity ("VIE") is an entity that lacks sufficient appropriate equity to finance its activities or whose equity holders lack adequate decision-making ability. Almost any legal structure used to hold assets or conduct activities might be a variable interest entity, including corporations, partnerships, limited liability companies, majority-owned subsidiaries and trusts.



## 1. Summary of significant accounting policies (continued)

### (r) Consolidation of variable interest entities (continued)

Under the standard, an entity must consolidate a VIE if it holds equity investments, guarantees, subordinated loans, derivatives or other "variable interests" in the VIE that expose the entity to the majority of the VIE's "expected losses". If no one entity has exposure to the majority of expected losses of the VIE, the entity with the majority of its "expected residual returns" must consolidate it.

The adoption of this guideline had no impact on the Company's consolidated financial results.

### (s) Hedging relationships

The Company has adopted the CICA issued Accounting Guideline 13 ("AcG 13"), "Hedging Relationships", which clarifies circumstances in which hedge accounting is appropriate. The guideline requires that all financial instruments that do not qualify as a hedge under the AcG 13, or are not designated as a hedge, be recorded in the balance sheet as either an asset or a liability with changes in fair value recognized in earnings. The Company enters into numerous financial instruments to manage its commodity price risk that do not qualify as hedges under the new accounting guideline. As a result, the Company has elected to not apply hedge accounting to any of its financial instruments.

### (t) Accounting by a vendor for consideration given to a customer

Effective October 1, 2006, the Company adopted the recommendations of the CICA EIC 156, "Accounting by a Vendor for Consideration Given to a Customer", which provides guidance on the accounting treatment and classification of sales incentives or other consideration that are offered by a vendor to direct or indirect customers. The guideline requires that any sales incentives or other consideration provided to a customer should be recorded as a reduction of revenue or, when certain conditions are met, as a sales operating expense. We provide certain customers with sales incentives that are based on their achieving Company defined purchase quotas.

## 2. Future changes in accounting policies

The Accounting Standards Board has issued new accounting standards for financial instruments that comprehensively address when an entity should recognize a financial instrument on its balance sheet, or how it should measure the financial instrument once recognized. The new standards comprise three sections of the CICA handbook:

- (a) CICA Section 3855, "Financial Instruments-Recognition and Measurement", establishes the criteria for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. It also specifies how financial instrument gains and losses are to be presented. The impact of the adoption of this new section on the consolidated financial statements is not expected to be material.
- (b) CICA Section 3865, "Hedges", provides optional alternative treatments to CICA Section 3855 for entities which choose to designate qualifying transactions as hedges for accounting purposes. It will replace AcG-13, "Hedging Relationships", and build on CICA Section 1650, "Foreign Currency Translation", by specifying how hedge accounting is applied and what disclosures are necessary when CICA Section 3865 is applied. The impact of the adoption of this new section on the consolidated financial statements is not expected to be material.
- (c) CICA Section 1530, "Comprehensive Income", establishes standards for the reporting and display of comprehensive income. These standards require that an entity present comprehensive income and its components in a separate financial statement that is displayed with the same prominence as other financial statements.

These standards will be effective for the Company as of January 1, 2007 and will be adopted on a retroactive without restatement basis.

## 3. Financial instruments

### (a) Risk management activities

Concentration of credit risk on the Company's trade accounts receivable exists in the oil and gas industry. Management believes that the Company is exposed to minimal credit risk since the majority of its business is conducted with major companies in the industry.

### 3. Financial instruments (continued)

#### (a) Risk management activities (continued)

The Company is exposed to changes in petroleum and natural gas prices as a result of its use of petroleum feedstock and natural gas for processing at its Sundre and Slave Lake fractionation plants. The potential fluctuations in petroleum and natural gas prices could have a significant impact on the cost of producing its products and the profitability of the Company. This risk is reduced in part, from time to time, through the use of crude oil and natural gas forward purchase contracts. The contracts are not used for speculative trading purposes. Realized gains or losses on these contracts are reported as adjustments to petroleum and natural gas costs in the related production period.

The Company did not have any outstanding crude oil and natural gas forward purchase contracts as at December 31, 2006 or December 31, 2005.

#### (b) Fair values

The carrying values of cash and cash equivalents, accounts receivable, promissory note, bank indebtedness and accounts payable and accrued liabilities approximate their fair value due to the relatively short periods to maturity of these instruments. The fair value of the Company's long term debt is estimated based on market prices for same or similar instruments and approximates carrying value.

#### (c) Interest rate risk

The Company manages its interest rate risk on borrowings by utilizing a combination of short term fixed rates through the use of 30 to 90 day Bankers' Acceptance rates and floating rates on debt.

### 4. Acquisition

On May 1, 2006, the Company acquired all of the outstanding common shares of Millard Trucking Ltd. and J.D.M. Trucking Ltd. ("Millard") for an aggregate purchase price of \$3,265,000.

Millard is a Sundre, Alberta based company involved in providing transportation services to the oil and gas industry. The operations of Millard Trucking Ltd. and J.D.M. Trucking Ltd. were amalgamated effective May 12, 2006 and have been continued under the name of Millard Trucking Ltd., a wholly owned subsidiary of Enerchem. The results from operations of Millard are included in the Transportation Services segment.

This acquisition has been accounted for by the purchase method and the results of operations have been included in these consolidated financial statements from the date of acquisition. The cost of the purchase has been allocated to the acquired assets based on their estimated fair values at the date of the acquisition. Details of the acquisition are as follows:

As at May 1, 2006

	\$
Current assets	2,707,614
Property and equipment	4,521,000
<u>Total assets acquired</u>	<u>7,228,614</u>
Current liabilities	2,421,578
Long-term debt	848,408
Future income taxes	693,628
<u>Total liabilities assumed</u>	<u>3,963,614</u>
<u>Net assets acquired</u>	<u>3,265,000</u>

The consideration was by way of:

Cash	2,733,000
100,000 common shares	532,000
	<u>3,265,000</u>

The value of the 100,000 common shares issued was determined based on the simple average of the closing prices of Enerchem's common shares on the Toronto Stock Exchange for the period near the date of acquisition.

## 5. Discontinued operations

On December 31, 2005, the Company sold the inventory and property, plant and equipment associated with its specialty chemical operations for \$13,244,000. The net gain on the sale of the discontinued operations amounted to approximately \$3,747,000 after income taxes of \$1,484,000. Revenues of \$15,789,089 for 2005 from these discontinued operations are excluded from total revenues in the Statement of Operations.

Revenues and operating activities of the specialty chemical operations for the year ended December 31, 2005 were as follows:

	2005
	\$
Revenues	15,789,089
Cost of sales	7,382,896
Gross profit	8,406,193
Expenses	
Salaries and employee benefits	2,905,597
Selling, general and administration	3,796,422
Depreciation and amortization	791,392
Interest expense	79,425
Other (income)	(1,081)
Total expenses	7,571,755
Earnings from discontinued operations	834,438
Income taxes	291,139
Net earnings from discontinued operations	543,299
Net gain on sale of specialty chemical operations	3,746,931
Net earnings from discontinued operations	4,290,230

## 6. Property, plant and equipment

	December 31, 2006			December 31, 2005		
	Cost	Accumulated depreciation	Net	Cost	Accumulated depreciation	Net
	\$	\$	\$	\$	\$	\$
Land	674,608	-	674,608	72,859	-	72,859
Buildings and blend plant facilities	4,175,862	499,629	3,676,233	1,611,926	404,513	1,207,413
Laboratory equipment	74,752	16,618	58,134	73,235	10,187	63,048
Oilfield equipment	235,419	33,580	201,839	110,402	53,681	56,721
Fractionation processing facilities	28,488,110	4,803,336	23,684,774	25,534,580	4,074,561	21,460,019
Leasehold improvements	117,104	22,141	94,963	14,137	8,226	5,911
Automotive equipment	3,786,582	1,148,423	2,638,159	746,270	663,564	82,706
Oilfield trailers	1,801,819	112,559	1,689,260	-	-	-
Office, computer equipment & software	388,501	228,948	159,553	319,465	230,681	88,784
	39,742,757	6,865,234	32,877,523	28,482,874	5,445,413	23,037,461

Buildings and blend plant facilities includes \$1,971,243 (December 31, 2005 - \$60,000) of costs associated with a flowback treatment facility under construction in Sundre. Fractionation processing facilities includes \$97,306 (December 31, 2005 - \$1,246,423) of costs associated with projects under construction at the Slave Lake fractionation plant. Costs associated with these projects have not been depreciated as they have not yet been completed and put in to use.

## 7. Other assets

	December 31, 2006	December 31, 2005
	\$	\$
Investments-foreign operations	1,114,442	1,114,442
Pre-operating costs	86,871	173,742
Deferred charges	297,631	173,520
Other	10,959	13,405
	1,509,903	1,475,109
Less: Write down of Investments - foreign operations	230,000	-
	1,279,903	1,475,109



## 7. Other assets (continued)

### (a) Investments-foreign operations

Investments-foreign operations represent the Company's investment in its operations in Egypt. During fiscal 1996, the Company entered into an agreement to construct a blend plant in Egypt with Blend Oil Services & Supply. This agreement led to the incorporation of the Egyptian Canadian Company for Chemicals Industries - F.Z. ("ECC"), operating in the free zone area of Alexandria, Egypt. The Company invested \$750,000 U.S. (\$1,114,442 Cdn.) maintaining its 25% interest in ECC. The Company accounts for its investment in ECC on the cost basis as it does not exercise significant influence.

Subsequent to December 31, 2006, the Company arranged to sell its 25% interest in ECC for total proceeds of \$750,000 U.S. (approximately \$880,000 Cdn.) to a privately held Egyptian company based in Cairo, Egypt. At December 31, 2006, the Company recorded a \$230,000 write down in respect of the carrying value of its Egyptian investment. The transaction is anticipated to close late March 2007.

### (b) Pre-operating costs

Pre-operating costs represent the costs incurred during the start-up of the Company's Slave Lake fractionation plant. The pre-operating period ended January 1, 2003 and the costs are being amortized over a period of five years. At December 31, 2006 accumulated amortization of pre-operating costs is \$347,484 (December 31, 2005 - \$260,613).

### (c) Deferred charges

Deferred charges represent the costs incurred for scheduled turnaround maintenance programs for the Company's fractionation plants. The Company's turnaround maintenance program is described in note 1(j).

## 8. Bank indebtedness

	December 31, 2006	December 31, 2005
	\$	\$
Demand revolving operating line	-	3,228,132

The Company has a \$5,500,000 (December 31, 2005 - \$15,000,000) revolving operating line and a \$10,000,000 (December 31, 2005 - \$5,000,000) bank guarantee facility with a Canadian chartered bank. The guarantee facility bears a fee of 1.35% per annum at the time of issuance of each bank guarantee. Advances under the operating line are available at either of the bank's prime rate plus 0.40%, Bankers' Acceptance rates plus 1.65%, or a combination thereof and are repayable on demand. At December 31, 2006, the Company has an outstanding bank guarantee in the amount of \$800,000 (December 31, 2005 - \$NIL) in respect of the purchase of petroleum feedstock.

These revolving operating loans are restricted to specific margin requirements and the Company has pledged an assignment of accounts receivable and inventories, a general security agreement creating a first priority security interest in all present and after acquired personal property of the Company and a floating charge over all of the Company's present and after acquired real property as collateral on its demand revolving operating loans, bank guarantees and long-term debt with the bank.

## 9. Long-term debt

	December 31, 2006	December 31, 2005
	\$	\$
Finance contract loans bearing interest at fixed rates of 0% per annum on service vehicles to 6.25% per annum on heavy commercial vehicles, repayable in blended monthly payments of \$10,662 and mature at varying dates from April, 2008 to August, 2010, specific equipment with a net book value of \$308,802 have been pledged as collateral.	287,062	-
Demand non-revolving loans	-	3,047,764
Less: current portion of long-term debt	115,585	1,215,488
	171,477	1,832,276

## 9. Long-term debt (continued)

The Company has a \$8,000,000 (December 31, 2005 - \$5,953,000) demand revolving credit facility with a Canadian chartered bank, that bears interest at the bank's prime rate plus 0.90%, for the Company's projects at its facilities and equipment purchases. The bank's prime rate at December 31, 2006 was 6.00% (December 31, 2005 - 5.00%). During 2006, the Company repaid demand non-revolving loans in the amount of \$3,047,764 which at December 31, 2005 were repayable in blended monthly payments of \$113,526 and had maturity dates varying from May 2006 to May 2020.

While the bank's credit facility is demand in nature, repayment of the debt in advance of the agreed terms is not at the bank's discretion provided the Company is not in default of its obligations, covenants and other conditions to the facility that will materially affect the Company's ability to fulfill its obligations. The Company was in compliance with these covenants at December 31, 2006 and 2005.

Finance contract loans represent debt obligations assumed by the Company with the acquisition of Millard. At December 31, 2006, the Company repaid debt obligations of Millard totaling \$1,548,000.

Approximate principal repayments in each of the next five years are as follows:

	\$
2007	115,585
2008	110,040
2009	40,041
2010	21,396
2011 and thereafter	-

## 10. Asset retirement obligations

The Company has recorded the current fair value of its expected cleanup and site closure costs associated with the Slave Lake and Sundre plant locations. The analysis of the asset retirement obligation (ARO) is as follows:

	December 31, 2006	December 31, 2005
	\$	\$
Asset retirement obligations - beginning of period	180,292	169,320
Accretion expense	12,009	10,972
Asset retirement obligations - end of period	192,301	180,292

With the adoption of this standard at December 31, 2004, \$137,261 has been included in property, plant and equipment. Included in depreciation and amortization of plant and equipment for the amortization of the ARO is a charge of \$3,221 (December 31, 2005 - \$3,221) for the year ended December 31, 2006.

The following assumptions were used to estimate the fair values of the obligation on the date the obligation was incurred:

Total undiscounted amount of the estimated cash flows	\$1,186,000
Expected timing of payment of cash flows	2033 and 2041
Credit adjusted risk free rate	6.49% and 6.87%

The estimate of the total liability for future asset retirement obligations is subject to change based on amendments to laws and regulations and as new information concerning the Company's operations becomes available. Future changes, if any, to the estimated total liability as a result of amended requirements, laws, regulations and operating assumptions may be significant and would be recognized prospectively as a change in estimate, when applicable.

## 11. Share capital and Contributed surplus

### (a) Authorized -

20,000,000 non-voting, preferred shares, rights to be determined upon issue  
Unlimited number of common shares

### (b) Issued -

Common

	December 31, 2006		December 31, 2005	
	#	\$	#	\$
Balance - beginning of period	14,820,807	27,973,843	14,594,610	27,465,971
Issue of shares for cash upon exercise of stock options	374,500	1,146,730	150,000	292,500
Compensation expense relating to stock options exercised	-	23,125	-	-
Issue of shares upon acquisition of Millard	100,000	532,000	-	-
Issue of shares for cash through employee share purchase plan	-	-	76,197	215,372
Balance - end of period	15,295,307	29,675,698	14,820,807	27,973,843

### (c) Contributed surplus

	December 31, 2006	December 31, 2005
	\$	\$
Balance - beginning of period	927,199	591,431
Stock based compensation expensed during the period	219,599	335,768
Compensation expense relating to stock options exercised	(23,125)	-
Balance - end of period	1,123,673	927,199

### (d) Stock options

The Company has reserved 2,700,000 common shares for issuance pursuant to an approved stock option plan ("Option Plan") granted to directors and employees of the Company. Stock options granted to employees vest over different periods and amounts from the date of grant and expire five years after the date of grant. The exercise price of each option equals the market price of the Company's common shares at the date of grant. A summary of the status of the Company's Option Plan is presented below:

	December 31, 2006		December 31, 2005	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
	#	\$	#	\$
Common shares under option-beginning of year	1,026,000	3.35	1,226,000	3.11
Share options granted	-	-	394,000	3.05
Share options cancelled	(117,500)	4.21	(434,000)	2.89
Share options expired	-	-	(10,000)	2.70
Share options exercised	(374,500)	3.06	(150,000)	1.95
Common shares under option-end of year	534,000	3.36	1,026,000	3.35
Options exercisable at end of year	302,167	3.60	517,000	3.52



## 11. Share capital and Contributed surplus (continued)

### (d) Stock options (continued)

The following options were outstanding and exercisable under the Option Plan at December 31, 2006:

Expiry Date	Outstanding			Exercisable		
	Options	Exercise Price	Weighted Average Price	Weighted Average Remaining Years of Contractual Life	Options	Weighted Average Exercise Price
	#	\$	\$		#	\$
May 9, 2007	60,000	5.15	5.15	0.4	60,000	5.15
August 8, 2008	10,000	3.25	3.25	1.6	7,500	3.25
January 20, 2009	100,000	3.40	3.40	2.1	100,000	3.40
January 4, 2010	344,000	3.05	3.05	3.0	114,667	3.05
January 7, 2010	20,000	3.30	3.30	3.0	20,000	3.30
	534,000		3.35	2.5	302,167	3.60

During the year ended December 31, 2006, the Company did not grant stock options (December 31, 2005 - 394,000 with exercise prices ranging from \$2.70 to \$3.30). The fair value of the options granted for the year ended December 31, 2005 were estimated using the Black-Scholes option pricing model at \$1.47 per option. The assumptions used in the pricing model were as follows:

Risk free interest rate (%)	3.72
Expected life of options (years)	5
Expected volatility (%)	51
Dividend yield (%)	0

The impact of expensing the stock options for the year ended December 31, 2006 was \$219,599 (December 31, 2005 - \$335,768), with a corresponding increase in contributed surplus.

Subsequent to December 31, 2006, 100,000 options were granted to an employee of the Company at an exercise price of \$3.75 per share.

The Company terminated its Employee Share Purchase Plan effective July 1, 2005 and, in place thereof, adopted an employee bonus plan providing for cash compensation based upon the attainment of designated objectives. Under the Company's Employee Share Purchase Plan, employees electing to participate in the plan could contribute a minimum of two percent to a maximum of five percent of monthly salaries. The employees' contributions were matched equally by the Company. Common shares acquired under the plan vested with the employees upon purchase and were distributed to the employees on an annual basis. The Company's contributions to the plan were recorded as compensation costs in the month incurred and totaled \$107,686 for the year ended December 31, 2005. During fiscal 2005, 76,197 shares were issued under the plan for proceeds totaling \$215,372.

### (e) Net earnings per share

Basic earnings per share is calculated using the reported net earnings divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated on the basis of the weighted average number of common shares outstanding recognizing the effect of outstanding stock options and their equivalent using the treasury stock method.

## 11. Share capital and Contributed surplus

### (e) Net earnings per share (continued)

A reconciliation of the denominators used for the computation of basic and diluted earnings per share are as follows:

	December 31, 2006	December 31, 2005
	#	#
<b>Weighted average share reconciliation</b>		
- Basic		
Common shares - opening	14,820,807	14,594,610
Weighted average of common shares issued during the period	351,029	199,102
	15,171,836	14,793,712
- Diluted		
Basic weighted average common shares - opening	15,171,836	14,793,712
Dilutive effect of stock options and equivalents	190,837	2,318
	15,362,673	14,796,030

## 12. Interest expense

Interest expense is comprised as follows:

	December 31, 2006	December 31, 2005
	\$	\$
Interest on bank indebtedness	10,153	131,229
Other interest	7,477	3,760
Interest on long-term debt	52,502	114,929
	70,132	249,918

## 13. Income taxes

The following table reconciles income taxes from operations calculated at the combined statutory federal and provincial tax rate with the income tax provision in the financial statements.

	December 31, 2006	December 31, 2005
	\$	\$
Income taxes based on combined statutory Canadian federal and provincial tax rate	2,689,740	1,996,188
Substantively enacted rates	(416,077)	-
Non-deductible and other	74,465	56,808
	2,348,128	2,052,996
Cash income taxes paid	4,744,062	-
Refunds received during the year	121,423	-
Net cash income taxes paid	4,622,639	-

Significant components of the Company's future tax liabilities (assets) are as follows:

	December 31, 2006	December 31, 2005
	\$	\$
Prepaid expenses and deferred charges	95,191	62,640
Property, plant and equipment	4,382,848	4,023,191
Non-capital losses	-	-
Other assets	20,873	51,541
Accounts payable and accrued liabilities	-	(68,363)
Asset retirement obligation	(57,775)	(60,614)
Share issuance costs	(1,430)	(68,395)
	4,439,707	3,940,000

## 14. Supplementary cash flow information

	December 31, 2006	December 31, 2005
	\$	\$
Cash interest income received	238,385	62,405
Cash interest expense paid	57,943	329,343

## 15. Net cash provided by discontinued operations

	December 31, 2006	December 31, 2005
	\$	\$
Net earnings from discontinued operations (note 5)	-	4,290,230
Items not affecting cash -		
Depreciation and amortization	-	791,392
Gain on sale of property, plant and equipment	-	(8,670)
Gain on sale of specialty chemical operations	-	(3,746,931)
Future income taxes	-	(400,881)
	-	925,140
Net change in non-cash components of working capital	-	3,186,296
Net cash provided by discontinued operations	-	4,111,436

## 16. Commitments

### (a) Leases

The future minimum lease payments under operating leases amount to \$553,457 (December 31, 2005 - \$793,096) and for each of the next five years are:

	\$
2007	265,797
2008	168,775
2009	118,885
2010	-
2011	-

### (b) Petroleum feedstock

The Company has entered into contracts of varying terms and quantities for the purchase of petroleum feedstock for processing. These contracts are not speculative.

### (c) Chemical purchases

The Company had entered into a two year chemical purchase contract effective December 1, 2003 with a U.S. based private company guaranteeing that the Company would purchase chemicals at market prices in amounts no less than \$500,000 U.S. (\$600,150 CDN) in each of 2004 and 2005. During 2005, the Company completed its purchase commitment with that supplier.

### (d) Letters of guarantee

At December 31, 2006, the Company had provided an \$800,000 letter of guarantee, which terminated January 2007, in favour of a supplier for purchases of petroleum feedstock from that company. Letters of guarantee are provided by the Company on an on-going basis and for varying amounts for its petroleum feedstock purchases from suppliers.

## 17. Contingent liabilities

In the normal course of business, the Company is party to various claims and legal proceedings. While the final outcome with respect to the claims and legal proceedings pending as at December 31, 2006, cannot be determined with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the Company's financial position or results of operations.

## 18. Segmented information

The Company's activities are divided into three distinct business segments: Oilfield Services which represents the manufacture and sale of hydrocarbon products; Energy Marketing which represents the purchasing, gathering and marketing of crude oil for resale to refiners and other customers; and Transportation Services which represents the operations of Millard. All of these business segments operate in one geographic region being the Western Canadian Sedimentary Basin. In the following tables, the elimination of significant inter-segment transactions are reflected under the caption "Eliminations".



## 18. Segmented information (continued)

December 31, 2006

	Oilfield Services	Energy Marketing	Transportation Services	Eliminations	Total
	\$	\$	\$	\$	\$
Revenues	75,667,971	25,423,192	10,044,832	(3,389,781)	107,746,214
Cost of Sales	61,386,740	21,885,252	6,750,380	(3,145,645)	86,876,727
Gross Profit	14,281,231	3,537,940	3,294,452	(244,136)	20,869,487
Depreciation, amortization and accretion expense	1,146,608	-	630,431	-	1,777,039
Interest expense	22,705	-	47,427	-	70,132
Other income	177,310	-	37,450	-	214,760
Earnings from operations	3,558,055	3,241,667	1,575,633	(96,651)	8,278,704
Income taxes	984,107	896,600	467,421	-	2,348,128
Net earnings	2,573,948	2,345,067	1,108,212	(96,651)	5,930,576
Total Assets	64,154,259	1,566,217	8,445,711	(5,611,632)	68,554,555
Capital expenditures	7,127,835	-	1,238,403	-	8,366,238
Goodwill	6,049,530	-	-	-	6,049,530

During 2006, the Energy Marketing segment had sales to one customer accounting for approximately 59% (December 31, 2005 - 48%) of total revenues provided by this segment. During 2006, the Oilfield Services segment had sales to one customer accounting for approximately 19% (December 31, 2005 - \$NIL) of total revenues provided by this segment.

December 31, 2005

	Oilfield Services	Energy Marketing	Transportation Services	Eliminations	Total
	\$	\$	\$	\$	\$
Revenues	72,072,308	37,059,971	-	-	109,132,279
Cost of Sales	59,577,312	32,880,242	-	-	92,457,554
Gross Profit	12,494,996	4,179,729	-	-	16,674,725
Depreciation, amortization and accretion expense	786,867	-	-	-	786,867
Interest expense	249,918	-	-	-	249,918
Other income	56,427	-	-	-	56,427
Earnings from operations	2,584,422	3,353,082	-	-	5,937,504
Income taxes	925,690	1,127,306	-	-	2,052,996
Net earnings	1,658,732	2,225,776	-	-	3,884,508
Total Assets	70,476,057	3,444,948	-	-	73,921,005
Capital expenditures	3,855,596	-	-	-	3,855,596
Goodwill	6,049,530	-	-	-	6,049,530


## 19. Comparative figures

Certain comparative figures have been reclassified to conform with the current year's presentation.









## Shareholder information

Shareholders may obtain copies of annual and quarterly reports, news releases, product information and other Company information by contacting:

### Investor Relations

Mr. Douglas Robinson  
Enerchem International Inc.  
First Alberta Place  
1950, 777 - 8th Avenue S.W.  
Calgary, Alberta T2P 1R5  
T: 403.269.1500  
F: 403.269.1559

Enerchem International Inc.

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1950, 777 - 8th Avenue S.W.  
Calgary, Alberta  
CANADA T2P 3R5

---

T: 403.269.1500  
F: 403.269.1559

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[www.enerchem.com](http://www.enerchem.com)